84-1076

Office-Supreme Court, U.S.
FILED
JAN 2 1985
ALEXANDER L. STEVAS,
CLERK

No. 84-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

VS.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., *et al.*
Appellees.

On Appeal from the Supreme Court of Mississippi

JURISDICTIONAL STATEMENT

JOHN MARSHALL GROWER
(Counsel of Record)
JEFFERSON D. STEWART
R. WILSON MONTJOY, II
BRUNINI, GRANTHAM, GROWER & HEWES
1400 First National Bank Building
Post Office Drawer 119
Jackson, Mississippi 39205
Telephone: (601) 948-3101

R. V. LOFTIN, JR.
THOMAS E. SKAINS
DAVID A. GLENN
TRANSCONTINENTAL GAS PIPE LINE CORPORATION
Attorneys for Appellant

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

QUESTIONS PRESENTED

1. By enacting the Natural Gas Policy Act of 1978 did Congress intend to cede to the states its preemptive jurisdiction over interstate pipelines and their purchase and transportation of natural gas for resale in interstate commerce, thereby overruling *Northern Natural Gas Co. v. State Corporation Commission* 372 U.S. 84 (1963)?

2. Does Mississippi's attempted regulation of interstate pipeline companies' purchase of "high cost" gas constitute an impermissible burden on interstate commerce under present market conditions?

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Wiley Fairchild, Rodney Fairchild, W. R. Fairchild Construction Company, Ltd., Getty Oil Company, Inexco Oil Company, and Tomlinson Interests, Inc. are producers who have appeared in opposition to Transcontinental Gas Pipe Line Corp. at all stages of the proceedings.

The following persons personally appeared before the Mississippi State Oil and Gas Board at the initial proceeding:

Susan W. Clements Lay
Lane Petroleum Corp.
Louis G. Ridgeway
Daniel E. Herlihy
Bryant M. Allen

Transcontinental Gas Pipe Line Corporation is a wholly-owned subsidiary of Transco Energy Company. Affiliates of Transcontinental Pipe Line Company are Border Gas, Inc. and NESP Supply Corp.

TABLE OF CONTENTS

	Page
OPINIONS BELOW	1
JURISDICTION	2
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	2
STATEMENT OF THE CASE	2
THE QUESTIONS ARE SUBSTANTIAL	8
CONCLUSION	25
CERTIFICATE OF SERVICE	25
APPENDIX A	1a
APPENDIX B	59a
APPENDIX C	104a
APPENDIX D	114a
APPENDIX E	115a
APPENDIX F	116a
APPENDIX G	119a
APPENDIX H	130a
APPENDIX I	136a

TABLE OF AUTHORITIES

CASES	Page
Atchison, Topeka & Santa Fe Railway Co. v. Public Utilities Commission, 346 U.S. 346 (1953)	2
Botany Worsted Mills v. United States, 278 U.S. 282 (1928)	14
Champlin Refining Co. v. Corporation Commission, 286 U.S. 210 (1932)	21
Cities Service Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179 (1950)	22, 23, 24
Colorado Interstate Gas Co. v. State Corporation Commission, 386 P.2d 266 (Kan. 1963), *cert. denied*, 379 U.S. 131 (1964)	21
Energy Reserves Group, Inc. v. Kansas Power & Light Co., 103 S.Ct. 697 (1983)	14, 23
Exxon Corp. v. Eagerton, 103 S.Ct. 2296 (1983)	13, 14
FPC v. Corporation Commission, 362 F.Supp. 522 (W.D. Okla. 1973), *aff'd*, 415 U.S. 961 (1974)	22, 23, 24
FPC v. Louisiana Power & Light Co., 406 U.S. 621 (1972)	10, 13
Hughes v. Alexandria Scrap Corp., 426 U.S. 794 (1976)	20
Hughes v. Oklahoma, 441 U.S. 322 (1979)	19
Lewis v. B. T. Investment Managers, 447 U.S. 27 (1980)	19
Maryland v. Louisiana, 451 U.S. 725 (1981)	14
Northern Natural Gas Co. v. State Corporation Commission, 372 U.S. 84 (1963)	9, 10, 11, 14, 20, 21
Panhandle Eastern Pipe Line Co. v. Public Service Commission, 332 U.S. 507 (1947)	10
Pennsylvania v. West Virginia, 262 U.S. 553 (1923)	22
Philadelphia v. New Jersey, 437 U.S. 617 (1978)	22
Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954)	23, 24
Pike v. Bruce Church, 397 U.S. 137 (1970)	21
Public Service Commission v. Mid-Louisiana Gas Co., 103 S.Ct. 3024 (1983)	12, 14
United Gas Pipe Line Co. v. FPC, 385 U.S. 83 (1966)	10

Table of Authorities (Continued)

Page

CONSTITUTION AND STATUTES:

United States Constitution:

article I, section 8, clause 3 (Commerce Clause) 8, 15, 20, 21

article VI, section 2 (Supremacy Clause) 7, 8

Natural Gas Act:

15 U.S.C. §§ 717-717w 9, 15

15 U.S.C. § 717(b) 3, 9

Natural Gas Policy Act:

15 U.S.C. §§ 3301-3432 ..... 9, 15, 16

15 U.S.C. § 3301(15) 3

15 U.S.C. § 3317 3

15 U.S.C. § 3431 ..... 9, 12, 13

15 U.S.C. § 3432 ..... 13, 15

28 U.S.C. § 1257(2) 2

Miss. Code Ann. § 53-1-1 (1972) 19

MISCELLANEOUS:

Energy Information Administration, U.S. Dept. of Energy, *Natural Gas Monthly* (Aug. 1984) 17

Energy Information Administration, U.S. Dept. of Energy, *Structure & Trends in Natural Gas Wellhead Contracts* (1983) 4, 15, 17, 19, 24

H. Broadman & W. Montgomery, *Natural Gas Markets After Deregulation* (1983) 4, 16, 17, 19, 24

H.R. Rep. No. 814, 98th Cong., 2d Sess. (1984) 12

H.R. 4277, 98th Cong., 2d Sess. (1984) 15

Proposed changes to Natural Gas Laws (Part 1): Hearings Before the Subcomm. on Fossil and Synthetic Fuels of the House Comm. on Energy and Commerce, 98th Cong., 1st Sess. (1983) 16, 17

Table of Authorities (Continued)

	Page
Inquiry Into Purchasing Practices of Interstate Pipelines, 48 Fed.Reg. 25264 (1983)	13
S. Conf. Rep. No. 1126, 95th Cong., 2d Sess. (1978)	13
Statewide Rule 48 of the Miss. State Oil and Gas Board	7
Transcontinental Gas Pipe Line Corp., 23 FERC ¶ 61292 (1983)	13
Transcontinental Gas Pipe Line Corp., 14 FERC ¶ 61204 (1981)	13

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

VS.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

JURISDICTIONAL STATEMENT

Transcontinental Gas Pipe Line Corporation (Transco) makes this appeal from the judgment of the Mississippi Supreme Court, entered on September 5, 1984, upholding a regulation and order of the State Oil and Gas Board of Mississippi in the face of federal constitutional challenges. Transco submits this statement to show that the Supreme Court of the United States has jurisdiction over the appeal and that a substantial question is presented.

OPINIONS BELOW

The opinion of the Mississippi Supreme Court (App. A, *infra*, 1a-58a) is reported at 457 So.2d 1298 (Miss. 1984). The

opinion of the Circuit Court of Hinds County, Mississippi (App. B, *infra*, 59a-103a) is not reported. The order of the Mississippi State Oil and Gas Board (App. C, *infra*, 104a-113a) is not reported.

JURISDICTION

This case involves a challenge to the constitutionality of Statewide Rule 48 of the State Oil and Gas Board of Mississippi. The Mississippi Supreme Court entered its judgment upholding the challenged regulation and order on September 5, 1984. (App. E, *infra* at 115a). A petition for rehearing was filed by Coastal Exploration, Inc. and was denied on October 5, 1984. (App. D, *infra* at 114a). Transco filed a notice of appeal to this Court on November 30, 1984 (App. F, *infra* at 116a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(2). *Atchison, Topeka & Santa Fe Railway Co. v. Public Utilities Commission*, 346 U.S. 346, 348 (1953).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The pertinent provisions are set forth in App. G, *infra*, 119a-129a.

STATEMENT OF THE CASE

Greens Creek Field and East Morgantown Field are two separately defined natural gas fields in Marion County, Mississippi. Greens Creek Field was discovered in 1976. The Harper Sand of that field was first encountered in 1978. Approximately five miles south of the Greens Creek Field, the East Morgantown Field was discovered. Its Harper Sand was discovered in March of 1979. In 1980, Getty Oil Company discovered additional Harper Sand production directly between these two fields with its Rogers 28-11 Well No. 1. As a result of this discovery, five additional wells were

drilled around the Rogers 28-11 No. 1. Some of these wells were within the area designated as the East Morgantown Field and some were in the Greens Creek Field, although all were producing from a common Harper Sand Gas Pool. All production from the Harper Sand of these two fields was below 15,000 feet and, thus "high cost gas" under § 107 of the Natural Gas Policy Act of 1978 (NGPA).[1]

Transco purchases gas and transports it from fields in Texas, Louisiana, Mississippi and the federal off-shore domain for resale to its customers along the pipeline extending from Texas to New York. It is a "natural gas company" under the Natural Gas Act and an "interstate pipeline" under the NGPA.[2] Transco had contracted with and had been purchasing gas from producers in the Greens Creek Field since 1978. On the basis of the reserves committed to it under those long term contracts, Transco had extended its pipeline facilities to that field. When the East Morgantown Field was discovered, Transco also entered into long term contracts with producers and, as a result thereof, extended its pipeline facilities to those wells in order to recover the dedicated reserves. When the Harper Sand Gas Pool production between these two fields was discovered in 1980, Transco already had some of that area dedicated under its prior contracts. Transco began taking gas under these contracts and entered additional contracts with other producers to cover their production.

By early 1982, Transco had approximately 35 different contracts with various producers in these two fields. Because these contracts were entered into at various times with different producers, there was a substantial difference in the contract terms. The principal differences involved the

---

[1]15 U.S.C. § 3317.

[2]15 U.S.C. § 717(b); 15 U.S.C. § 3301 (15).

price to be paid for gas and the quantity of gas which Transco was to purchase or pay for.

Transco, like every other interstate pipeline, had faced a severe shortage of available reserves and curtailment of its resales customers during the 1970's. As a result of the seller's market which prevailed while Transco competed for new reserves, some of the gas purchase contracts with producers in these fields contained provisions calling for Transco to take as much as 100% of the amount of gas which could be delivered from any well. In later contracts, the "take-or-pay" provisions called for Transco to take between 80 and 90% of the contract seller's deliverability in a well.[3]

The operators of the six wells in this pool each had a contract with Transco. However, not all of the producers in the Harper Sand Gas Pool entered into contracts with Transco. Many producers, like Coastal Exploration, Inc. (Coastal), did not have contracts but had elected to let the operator sell gas for their account under an operating agreement.[4]

---

[3]A "take-or-pay" provision is the most common form of minimum-quantity requirement in natural gas contracts. *See, e.g.*, Energy Information Administration, U.S. Dept. of Energy, *Structure and Trends in Natural Gas Wellhead Contracts* vi, 29-38 (1983) (hereinafter cited as EIA); H. Broadman and W. Montgomery, *Natural Gas Markets After Deregulation* 7 (1983) (hereinafter cited as Broadman). The provision typically requires a pipeline to either accept deliveries of natural gas and pay for it or pay for it with a right to accept delivery within a specified "make-up" time, usually several years. Under federal regulation, take-or-pay payments for gas not currently taken are capitalized and a return thereon is allowed to be charged to the consumer.

[4]An operating agreement is the usual means in the oil and gas industry of defining the rights and duties of an operator, *vis-a-vis* the nonoperating owners, as to the drilling and production of a well. In this case, every well involved in this dispute was covered by a form

Other producers had rejected contract offers by Transco but had failed to make arrangements to otherwise dispose of their gas. Still other producers in these wells had entered into contracts with another interstate pipeline company which, at the time of the Board hearing, was not taking any gas from the wells and had refused to purchase Coastal's gas.

Prior to the spring of 1982, Transco had sufficient market demand to take all volumes of gas tendered to it, both contract gas and the gas sold under operating agreements for the account of non-contract parties. However, in the spring of 1982, Transco began to experience problems in reselling the gas on its system. Transco's average cost of natural gas had significantly increased over the last two years because of the price increases and escalations allowed under the NPGA and because of the operation of contract pricing provisions applicable to price deregulated high cost gas.[5] Meanwhile, prices for alternate fuels were actually dropping. As a result, some industrial customers switched to cheaper fuel oils.

---

operating agreement which provided that (1) each party was to take in kind or separately dispose of its proportionate share of the oil or gas produced from the well and (2) in the event such party did not make arrangements necessary to take in kind or separately dispose of its share of oil or gas, the operator then had,

> the right, . . . but not the obligation, to purchase such oil and gas or sell it to others at any time from time to time, for the account of the non-taking party at the best price obtainable in the area for such production . . . only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances but in no event for a period of in excess of one year.

[5]In the spring of 1982, Transco's system-wide average cost of gas was $3.13/MMBtu. This was over 82% of Transco's average resale price of $3.78/MMBtu.

By May, 1982, Transco had lost resale markets for approximately 95-100 million cubic feet of gas per day. Transco was unable to take or sell all of the gas subject to the take-or-pay provisions of its gas purchase contracts. Because the cost of wellhead purchases was continuing to escalate, Transco projected an additional $.65-$.70 increase in its average cost of gas. This would result in inevitable loss of additional markets. Since Transco was experiencing market loss at its distribution end and was projecting further losses, it invoked contractual provisions allowing price or quantity reductions and asked its sellers for voluntary reductions in both prices and quantity obligations.[6] It also notified all of its contract producers that it would no longer purchase any gas that it was not contractually required to purchase.

This announcement had varying impacts on Transco's purchases from different wells because of the different terms and conditions of its contracts. Some producers had bargained for specific agreements in their contracts requiring Transco to take all gas produced from their wells, regardless of ownership. However, other contract parties had not made those arrangements and, under their contracts, Transco was only obligated to buy gas owned by that particular seller. Coastal had no contract to sell its gas and there were no contracts obligating Transco to take Coastal's gas from some of the Harper Sand wells.

On July 29, 1982, Coastal filed a petition with the Mississippi State Oil & Gas Board (Board) under the Board's Statewide Rule 48. The petition sought to force Transco to purchase Coastal's gas on the same terms and conditions

---

[6]Even with this effort, Transco was paying between $5.00 and $9.054 per MMBtu for the "Harper Sand" gas under contract from these fields. These prices were far greater than what Transco could resell gas for.

under which Transco was purchasing gas (under contract) from the well operators.[7] Rule 48 states:

> Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, or producers shall purchase without discrimination in favor of one owner, operator, or producer against another in the same common source of supply.

Transco, by written response to the Board, challenged the proceeding on a variety of state grounds and also urged that the Board's attempted regulation of an interstate pipeline was preempted by federal regulation, under the Supremacy Clause, U.S. Const. art VI, § 2. On October 13, 1982, the Board rejected all of Transco's challenges and entered its Order No. 409-82 finding Transco in violation of its Rule 48, and directing it to,

> ratably take and purchase gas without discrimination in favor of one owner, operator or producer against another in the said common source of pool [sic]. . . .

App. C, *infra* at 112a.

At no time in the proceedings did the Board consider reducing well allowables to accommodate the reduced market demand or establishing allowables on anything other than the wells' maximum deliverability. Though subtly couched, the Board's Order had the practical effect of forcing Transco to take quantities of high cost gas it had no contractual obligation to take and, therefore, reducing its takes of lower priced regulated gas from other fields.[8]

---

[7]The specific contracts under which Coastal was trying to force Transco to purchase its gas then called for a price of $7.90/MMBtu.

[8]The practical effect was created by the combination of the order, the acknowledged gas glut and the take-or-pay provisions in Transco's contracts. The result is an increase in its system costs which pass through to the consumer.

Transco appealed this order to the Circuit Court of the First Judicial District of Hinds County, Mississippi. Among its nine grounds of appeal, Transco contended that Board action was invalid under the Commerce and Supremacy Clauses of the Constitution. On June 28, 1983, the Circuit Court considered every assignment of error and affirmed the Board's order in its entirety.

Thereafter, Transco appealed to the Mississippi Supreme Court. On September 5, 1984, that Court entered its 58 page opinion rejecting Transco's position on all federal constitutional issues. However, the Mississippi Supreme Court found that the Board's attempt to regulate or proscribe differences in price, although constitutional, was not within the Board's statutory authority under Mississippi law.

On October 3, 1984, the Mississippi Supreme Court overruled a petition for rehearing filed by Coastal.

THE QUESTIONS ARE SUBSTANTIAL

I. Are State "Ratable-Take" Regulations Still Pre-Empted by Federal Regulation of Natural Gas Purchased and Transported for Resale in Interstate Commerce?

The State Oil & Gas Board of Mississippi has, in this case, attempted to revive a "ratable take" regulation admittedly unenforceable as to interstate pipelines prior to 1978. Oklahoma[9] and Texas[10] are now revising their ratable take regulations to be enforceable against interstate pipeline companies. The validity of this recent state assertion of jurisdiction hinges on the true scope of the decision reached in *Northern Natural Gas Co. v. State Corporation Commission*, 372 U.S. 84 (1963).

---

[9]See App. H, *infra*, at 130a-135a.

[10]See App. I, *infra*, at 136a-152a.

The Mississippi Supreme Court and producers in this case concede that *Northern Natural* would be dispositive but for the Natural Gas Policy Act of 1978 (NGPA).[11] However, they contend that since § 601(a)(1) of the NGPA has eliminated regulation under the Natural Gas Act[12] over the "first sale" of "high cost gas," an interstate pipeline's purchase of this gas is free from federal control and therefore subject to state regulation. This tunnel vision approach simply does not take into account the scope of federal jurisdiction over pipelines under the Natural Gas Act and the NGPA. It does, however, raise the substantial question of whether Congress, by "deregulating" prices of first sales of certain categories of natural gas, intended to allow states to regulate the quantity and price of gas purchased by an interstate pipeline and transported for resale in the interstate market.

1. The Natural Gas Act was enacted in 1938. It gave the Federal Power Commission (Commission) three independent bases of jurisdiction: (1) over "transportation of natural gas in interstate commerce"; (2) over "sales for resale in interstate commerce;" and (3) over "natural gas companies engaged in such transportation or sale." 15 U.S.C. 717(b).

Although Congress placed specific limitations on the Commission's jurisdictions over rates, the jurisdiction over transportation, and incidents of transportation, has not been construed so narrowly. *Compare Panhandle Eastern Pipe Line Co. v. Public Service Commission*, 332 U.S. 507 (1947) (rates of direct sales) *with FPC v. Louisiana Power and Light Co.*, 406 U.S. 621 (1972) (quantities of direct sales). "Where it is necessary to regulate the purchase of gas in some respects to carry out its expressly granted au-

---

[11]15 U.S.C. § § 3301-3432.

[12]15 U.S.C. § § 717-717w.

thority over transportation and sales, the Commission must have the power to do so." *United Gas Pipe Line Co. v. FPC*, 385 U.S. 83, 90 (1966).

In *Northern Natural*, this Court found Kansas ratable take orders preempted because they invaded the exclusive jurisdiction "which the Natural Gas Act has conferred upon the Federal Power Commission over the sale and transportation of natural gas in interstate commerce for resale." 372 U.S. at 89. The "imminent possiblity" of conflict was deemed sufficient to preempt state regulation:

> The danger of interference with the federal regulatory scheme arises because these orders are unmistakably and unambiguously directed at *purchasers* who take gas in Kansas for resale after transportation in interstate commerce. In effect, these orders shift to the shoulders of interstate purchasers the burden of performing the complex task of balancing the output of thousands of natural gas wells within the State, . . . a task which would otherwise presumably be the State Commission's. Moreover, any readjustment of purchasing patterns which such orders might require of purchasers who previously took unratably could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States. This relationship is a matter with respect to which Congress has given the Federal Power Commission paramount and exclusive authority. . . . The prospect of interference with the federal regulatory power in this area is made even more acute by the fact that criminal sanctions imposed by state statute for noncompliance fall upon such purchasers and not upon local producers.

Id. at 92.

The bases of the decision in *Northern Natural* could not have been more clear. The Kansas ratable take orders were thrown out because, (1) they were an attempt to directly regulate *purchasers* who were purchasing gas for transportation and resale in interstate commerce, and (2) the state's attempt to regulate *quantities* of gas purchased would inevitably conflict with and could seriously impair the Commission's "paramount and exclusive authority" to regulate the "intricate relationships between the purchaser's cost structures and eventual costs to wholesale customers who sell to consumers in other states." *Northern Natural*, 372 U.S. at 92. Thus, the conflict condemned in *Northern Natural* was not regulation of wellhead sales, but rather attempted regulation of the quantities of gas purchased by an interstate pipeline incident to its transportation and resale of that gas.

2. Serious supply imbalances between the intrastate and interstate markets, as well as concern about the overall level of price and supply of natural gas, led the Congress to enact the NGPA in 1978. The four major purposes of the NGPA have recently been characterized as follows:

> 1. To eliminate the disparity between interstate and intrastate markets.
>
> 2. Replace cost base regulation of wellhead prices with phased decontrol of most newly drilled gas.
>
> 3. Provide incentives to producers to engage in more exploration and production of natural gas while not permitting producers to reap windfall profits on gas discovered and produced for a relatively low cost.
>
> 4. Provide for an orderly transition to decontrol and mitigate the impact on residential consumers of the change in the way natural gas was controlled.

H.R. Rep. No. 814, 98th Cong., 2d Sess. 21 (1984). As this Court recently stated:

> The NGPA is designed to preserve the Commission's authority under the NGA to regulate natural gas sales from pipelines to their customers; however, it is designed to supplant the Commission's authority to establish rates for the wholesale market, the market consisting of so-called "first sales" of natural gas.

Public Service Commission v. Mid-Louisiana Gas Co., 103 S.Ct. 3024, 3031 (1983).

NGPA § 601[13] of the NGPA expresses how the NGPA has "supplanted" Commission regulation of first sales. Contrary to the opinion of the Mississippi Supreme Court, § 601(a)(1) does not purport to eliminate the Commission's jurisdiction over interstate pipeline companies. Commission jurisdiction over interstate pipelines does not attach *solely* because of a first sale.[14] Commission jurisdiction remains because interstate pipelines purchase all classifications of natural gas, transport it to other states, and resell the gas for ultimate public consumption.

3. The Commission claims its NGA jurisdiction includes control over the quantities and mix of *all* different categories of gas which a jurisdictional pipeline may purchase. *See FPC v. Louisiana Power & Light Co.*, 406 U.S. at 636. The Commission continues to assert jurisdiction over all of Transco's purchasing practices, despite price deregulation

---

[13]15 U.S.C. § 3431.

[14]The key to understanding that § 601(a)(1) has not eliminated FERC's NGA jurisdiction over pipelines is the phrase "solely by reason of" found in § § 601(a)(1)(A), (B), and (D). § 601(a)(1) declared that the designated new types of natural gas listed therein would no longer be placed under the Natural Gas Act "solely by reason of" the fact that the "first sale" was in interstate commerce. Furthermore, under § 601(a)(1)(D), the producers would no longer be considered "natural gas companies" under the Natural Gas Act "solely by reason of" the fact that they sold this new gas in interstate commerce.

of some first sales under the NGPA. *See, e.g., Transcontinental Gas Pipe Line Corp.*, 23 FERC ¶ 61292 (1983); *Transcontinental Gas Pipe Line Corp.*, 14 FERC ¶ 61204 (1981).

The inevitable conflict between the Commission's asserted jurisdiction over interstate pipeline purchasing practices and state ratable take regulation is even more evident in light of the Commission's *Inquiry Into Purchasing Practices of Interstate Pipelines*, 48 Fed. Reg. 25264 (1983). There, in addition to denouncing the Mississippi Board's invasion of its jurisdiction, the Commission indicated it would determine what, if any, regulatory controls on the purchasing practices of pipelines under its jurisdiction are necessary or proper.

4. NGPA § 601 was not designed to and does not address the relationship between federal regulation and state regulation. However, § 602(a)[15] of the NGPA does deal with that relationship. Under § 602(a), Congress expressly stated that it was ceding to the states regulatory control only over "first sales" in the *intrastate* market. S. Conf. Rep. No. 1126, 95th Cong., 2d Sess. 124-5 (1978); *Exxon Corp. v. Eagerton*, 103 S.Ct. 2296, 2303 (1983). Further, states are limited to establishing their own maximum lawful prices for these intrastate transactions "in accordance with the overall national policy." *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 103 S.Ct. 697, 710 (1983); *Exxon Corp. v. Eagerton*, 103 S.Ct. at 2303.

When Congress wished to delegate its power to the states it did so expressly. Given the comprehensiveness of the NGPA, the failure to make such an express grant of authority for gas in interstate commerce is an implicit indica-

---

[15] 15 U.S.C. § 3432.

tion by Congress that no such power was to be given to the states. *See Public Service Commission v. Mid-Louisiana Gas Co.*, 103 S.Ct. at 3034; *Botany Worsted Mills v. United States*, 278 U.S. 282, 289 (1928).

5. This Court has consistently held that Congress intended to completely occupy the field of natural gas sold and transported in interstate commerce. The pervasiveness of federal regulation of this field has heretofore precluded any state attempt to regulate natural gas sold or transported in interstate commerce. Since the enactment of the NGPA, this Court has, on two occasions, held that the federal domination of this field is still so complete that it precludes state regulation. *Exxon Corp. v. Eagerton*, 103 S.Ct. at 2304; *Maryland v. Louisiana*, 451 U.S. 725, 749-52 (1981) (citing *Northern Natural*). In neither of these cases was any direct conflict demonstrated between the state statutory scheme and existing FERC regulations. It was, rather, the mere infringement on the complete and exclusive federal regulatory scheme which preempted those state acts to the extent they applied to interstate pipelines or natural gas purchased and transported for resale in interstate commerce.

6. This Court has characterized the federal scheme of regulation as comprehensive even after the passage of the NGPA. Where Congress desired to allow some state regulation in intrastate sales of gas, it expressly delegated that power under § 602 of the NGPA. A substantial question is presented by this appeal as to (1) whether Congress has relinquished its complete occupation of the field of sales and transportation of natural gas in interstate commerce and (2) if so, whether Congress intended to give the states their first opportunity since 1938 to enter this field and regulate interstate pipelines.

II. Does the Enforcement of Mississippi's Regulations as to Purchases of High Cost Gas by Interstate Pipelines Impose an Undue Burden on Interstate Commerce?

There is currently a serious, nationwide problem in the natural gas industry. Despite a surplus of natural gas on the market, consumers and industries are forced to pay increasingly higher prices for this fuel as a result of federal regulation and the inflexibility of contracts between producers and pipeline purchasers of gas. *See* § 2, NATURAL GAS MARKET POLICY ACT OF 1984, H.R. 4277, 98th Cong. 2d Sess. (1984). Both Congress and the Department of Energy have recently devoted substantial attention to the causes and cures of this problem. *Id.*; EIA, *supra* note 3. This recent attention demonstrates a continuing federal interest in lower consumer gas prices.

This national problem can only be exacerbated by the action of the Board. The Board's recent enforcement of its Rule 48, combined with its refusal to consider the effect of its action on the interstate market, will inevitably cause increases in consumer prices of gas, and will have the practical effect of insulating Mississippi producers from a market problem common to producers in all states. Therefore, it violates the Commerce Clause of the United States Constitution. U. S. Const. art. I, § 8, cl. 3.

1. The present structure of the natural gas industry in this country is the product of many years of federal regulation under the Natural Gas Act and, more recently, the Natural Gas Policy Act of 1978. Between 1954 and 1978, the Commission regulated the price of gas in interstate commerce at the wellhead. However, in 1978 the NGPA was passed as a result of a shortage of gas available to the interstate market — a shortage caused principally by years of artifically low, controlled well-head prices. This shortage was characterized by inordinately high demand, a signifi-

cant reduction in exploration for new reserves and diversion of many available supplies of gas to the intrastate market. The NGPA extended federal control to the intrastate market to eliminate this disparity. It also allowed price increases with monthly escalations on all gas and price deregulation of "high cost" gas in order to encourage further development.

The NGPA goal of increased development was soon realized. After 1978, significant new reserves of natural gas were produced into the interstate market. By 1981, market demand began dropping. Factors such as conservation, reduction in the prices of competitive fuels, and unseasonably mild weather all contributed to this reduction in demand for natural gas. By 1982, deliverability to the interstate market exceeded demand. Broadman, *supra* note 3, at 9.

By 1982, interstate pipelines, which had faced severe shortages and the resulting curtailments before 1978, were faced with an oversupply of gas under burdensome contracts and a regulatory scheme designed to increase gas prices. Donald Hodel, the Secretary of Energy, succinctly described the problem in testimony before the House Energy Committee in 1983, stating:

> Pipelines are finding themselves bound by onerous contract terms they signed based upon a belief in scarcity that the regulations fostered. These contracts have prices tied to artificial regulatory ceilings that keep prices rising and they also have high take-or-pay provisions that incur the production of most expensive supplies first while production of less costly supplies is reduced . . . .

Proposed Changes to Natural Gas Laws (Part 1): Hearings Before the Subcomm. on Fossil and Synthetic Fuels of the House Comm. on Energy and Commerce, 98th Cong., 1st Sess. 293-94 (1983) (statement of Donald Hodel, U.S. Secre-

tary of Energy). The result was that consumer gas prices continued to increase despite an oversupply of gas on the market.[16]

In 1982, over 700 million dollars in take-or-pay costs were included in pipeline rates as a result of pipelines' inability to market contractually committed gas. EIA, *supra* note 3, at 38. Additionally, take-or-pay liabilities were expected to increase significantly in 1983 through 1985. *Id.* By 1982, the cost of gas purchased had become more than 70% of interstate pipelines' resale rates.[17] Finally, resale markets had become price sensitive due to the continued decrease in the prices of alternate energy sources, such as fuel oil. Broadman, *supra* note 3, at 9. The result was continued loss of industrial markets because of fuel switching, leaving the remaining consumers, primarily residential and commercial, to bear an even greater share of these increasing costs.

2. Despite the national market condition, the Board elected to enforce its Rule 48 against Transco. The effect of the Board's action, simply stated, was to require an interstate pipeline to take high cost gas it otherwise would not have to take. The Board expressly refused to consider evidence proffered on the interstate impact of such action and, at the same time, made no attempt to regulate the production in light of available market demand.

Transco had contracts with some, but not all, of the producers in the Harper Sand Gas Pool. However, it was ordered to take gas ratably from all producers in the pool. The Board left Transco with essentially three options to achieve ratable taking: (1) take no gas from these fields; (2)

---

[16]By the end of 1982, consumer gas prices were up to 24% higher than a year earlier. Broadman, *supra* note 3, at 9.

[17]*See* Energy Information Administration, U. S. Department of Energy, *Natural Gas Monthly* 23, 29 (Aug. 1984).

further reduce contract purchases in the fields to accommodate the non-contract quantities of gas; or (3) reduce its contract purchases in other fields and states.

Since Transco was already taking less gas than the take-or-pay provisions of its gas purchase contracts specified, any option involved a reduction in contract purchases somewhere on Transco's system. *Any* reduction in contract purchases under (1), (2), or (3) above would add additional take-or-pay claims to the Transco system.

Rule 48 is not limited to the two fields involved in this specific case. The Board's regulation, if constitutional, can be expected to be enforced in every other price-deregulated field or pool in the state.[18] The impact of applying Rule 48 on a statewide basis is twofold. First, pipelines must take significant additional volumes of higher-priced deregulated gas from Mississippi—gas which they are not contractually obligated to purchase. To accommodate these additional volumes in a time of restricted market demand, the pipelines must either reduce purchases of lower cost regulated gas or reduce purchases of other deregulated gas under contracts which have take-or-pay provisions. Either option will result in an increase in gas prices.[19] Second,

---

[18]The Mississippi Supreme Court made it clear it was sanctioning Board regulation of only gas deregulated under the NGPA. 467 So.2d at 1318 (App. A, *infra* at 29a).

[19]As noted in a recent study:

> The failure to take quantities of natural gas specified in supply contracts can subject pipelines to any of a variety of penalties. A survey of contract terms (EIA, 1982a) has shown that older contracts, involving gas with relatively low prices, are less stringent in their requirements or penalties than newer contracts for higher cost gas. As a result, when demand falls, pipelines may find it advantageous to reduce their purchases of old, low-priced gas. These purchase patterns can create an apparent supply glut,

because Mississippi is ignoring market demand in its regulation of production,[20] interstate pipelines will, as a practical matter, have to take more gas from Mississippi than they would otherwise. Therefore, they must necessarily purchase less gas from the producers in other states.

3. This Court has consistently instructed that one must look to the "practical effect" of any regulation in order to determine whether or not it imposes impermissible burdens on interstate commerce. *Lewis v. B. T. Investment Managers*, 447 U.S. 27, 37 (1980); *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979). However, the Mississippi Supreme Court dismissed the burden in this case by characterizing it as a burden solely on Transco rather than a burden on interstate commerce:

> It is hard to see how a ratable take rule or order could be said to generate an unreasonable burden on interstate commerce when the only thing requiring Transco (or any other interstate pipeline) to take at all, ratably or otherwise, is its own contract.

457 So.2d at 1322 (App. A, *infra* at 36a). This ignores the realities of the market-place. Long term contracts are at the heart of the interstate gas market. Purchased gas costs and

---

> with some producers willing to sell more gas than is being taken at contracted prices. The pattern of gas production that results may also fail to meet given demand at minimum cost, as gas with higher production costs may be taken while that with lower production costs is shut in.

Broadman, *supra* note 3, at 10-11.

[20]Mississippi has a statutory policy against regulating production based on market demand except where necessary to prevent waste. Miss Code Ann. § 53-1-1 (1972).

the cost of take-or-pay payments are charged to the interstate consumer.[21]

The Commerce Clause is designed to protect the "natural functioning" of the interstate market from burdensome state regulation. *See Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 805-06 (1976). Take-or-pay provisions have been in interstate gas purchase contracts for many years.[22] Any Commerce Clause inquiry must therefore consider the existence of these provisions in determining the practical effect of state regulation.

4. This Court's analysis of Commerce Clause cases in recent years has been carried out under a balancing test which is enunciated in *Pike v. Bruce Church*, 397 U.S. 137 (1970). Under the *Pike* formula, one must not only weigh the benefits of a challenged state regulation against its interstate burden, one must also inquire into less burdensome regulatory alternatives which may be available to the state. Both the Board and the Mississippi Supreme Court refused to consider regulatory alternatives. The Mississippi

---

[21]The Mississippi Supreme Court later recognized the true nature of the "practical effect" of this regulation by stating:

> Transco has the right to pass the costs it incurs in purchasing natural gas through to the consumer. 15 U.S.C. § 3431(c). In this sense, it is not Transco who experiences a burden, it is the consumer. If higher purchasing prices at the wellhead lead to higher prices to the consumer and a loss of markets, this is simply one inevitable consequence of the free market policies of the year of deregulation with respect to which Transco has vested by the negative commerce clause with no right to complain.

457 So.2d at 1322 (App. A *infra* at 37a-38a).

[22]In the 1963 *Northern Natural* case, the controversy was sparked by the impact of state ratable take regulations upon a pipeline with take-or-pay commitments in its contracts. 372 U.S. 89 and 372 U.S. at 98-99 (Harlan, J. dissenting).

Supreme Court sidestepped this admittedly serious inquiry by its finding that Transco had first failed to establish that the Board regulation poses an unreasonable burden on interstate commerce. 457 So.2d at 1322-23 (App. A, *infra* at 38a).

In this case, Mississippi has ignored a clearly constitutional alternative to achieve its stated purpose. The regulation of *production* of gas, rather than the interstate *purchasers*, would avoid forcing disproportionately high volumes of high cost gas onto the interstate market. This alternative means of preventing waste has been clearly sanctioned as constitutional. *Northern Natural*, 372 U.S. at 94 n.12; *Champlin Refining Co. v. Corporation Commission*, 286 U.S. 210, 235 (1932); *Colorado Interstate Gas Co. v. State Corporation Commission*, 386 P.2d 266, 285-86 (Kan. 1963), *cert. denied*, 379 U.S. 131 (1964).

The interstate pipelines should not be required to assume the burden of balancing production among wells. As stated in *Northern Natural*, such a "complex balancing task" is properly that of a state and should not be shifted to the shoulders of an interstate pipeline. 372 U.S. at 92.

5. The Commerce Clause question is substantial because the Board's action is discriminatory in effect. Mississippi has ignored regulatory alternatives which do not burden interstate commerce. The Board could have required producers to produce ratably only that quantity of gas which the market could take, and required that producers with contracts share the market. Instead the Board placed no restrictions on production and told Transco, which it knew had burdensome gas purchase contracts, to "ratably take and purchase high cost gas without discrimination."[23]

---

[23]The Board stated that it was not concerned with Transco's problems or whether its markets could absorb the additional volumes of gas.

The result is production from Mississippi in excess of market demand. This is discriminatory in that it alters Mississippi's market share relative to other states. It is likewise discriminatory in that waste is avoided by burdening the consumer of an interstate commodity with price increases in a time of oversupply. A state may not legitimately protect the correlative rights of its citizens by placing itself in a position of economic isolation, ignoring problems common to all and forcing others to bear the burden of its regulations. *Philadelphia v. New Jersey*, 437 U.S. 617, 623, 627-29 (1978); *Pennsylvania v. West Virginia*, 262 U.S. 553, 596-600 (1923).

If Mississippi's approach is deemed constitutional, other states will surely follow its lead. The approach has political appeal because it prevents waste but it does not require the local producers to share the limited markets. It places the burden directly on the interstate market. Unfortunately, the ultimate impact will fall upon the consumer.

6. The Commerce Clause question in this case is also substantial because producers and the Mississippi Supreme Court have relied on the ruling in *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179 (1950), a decision later distinguished in *FPC v. Corporation Commission*, 362 F. Supp. 522 (W.D. Okla. 1973), *aff'd*, 415 U.S. 961 (1974).

In *Peerless*, Oklahoma found that an excessively low gas price promoted waste of natural gas. The state thus ordered a price increase from a range of 3.6 to 5 cents per thousand cubic feet up to 7 cents. This Court approved the regulations because they did not burden interstate commerce, stating: "[T]he wellhead price of gas is but a fraction of the price paid by domestic consumers at the burner-tip, so that the field

price as set herein may have little or no effect on the domestic delivered price."*Id.* at 187.[24]

In *FPC v. Corporation Commission*, a case affirmed by this Court, subsequent Oklahoma regulations which set a minimum price of 20 cents per thousand cubic feet were found to place an impermissible burden on interstate commerce. 362 F. Supp. at 535. The District Court found that "*Peerless* no longer controls insofar as it holds that minimum price orders are not within the proscription of the Commerce Clause." *Id.* One basis for distinguishing *Peerless* was the difference in amount of the minimum price orders and their impact on the ultimate consumer.[25] The three judge panel stated:

> The Court said in *Peerless*, that "the wellhead price of gas is but a fraction of the price paid by domestic consumers at the burner-tip, so that field price as herein set may have little or no effect on the domestic delivered price." In *Phillips* [*Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954)], however, the Court declared that the "rates charged may have a direct and substantial effect on the price paid by the ultimate consumers." And be it noted that Mr. Justice Clark, who spoke for the Court in *Peerless*, dissented in *Phillips*.

Id.

---

[24]*Peerless* is distinguishable for additional reasons: there was no oversupply of gas on the market; the pipeline had no take-or-pay problems; the pipeline was also the major producer in the field; and, the court did not consider the availability of less burdensome alternatives.

[25]The other basis was lack of an expressed need for national uniformity at the time of *Peerless*. 362 F. Supp. at 535. Even in today's partially "deregulated" market, the need for a uniform national energy policy is still clear. *Energy Reserves*, 459 U.S. at 420-21.

In today's market, wellhead price is an even more important factor than at the time of *FPC v. Corporation Commission.*[26] The purchase cost of natural gas is now by far the largest component of the consumer price. In 1982, Transco's cost of gas was over 82% of the delivered price. The price increases which would be caused by Mississippi's regulation would have a substantial impact on the ultimate consumer and therefore demand a different ruling than that made in *Peerless.*

---

[26]As noted in one study:

> The NGPA provides for certain types of expensive production to qualify for unregulated prices. This section 107 "high cost" or "deep" gas has been the subject of a great deal of controversy because some contracted prices reached a high of around $9.00/mcf in early 1982. The actual range of high-cost gas prices in mid-1982 was $3.15 to $9.65/mcf (EIA, 1982b). While only about 7 percent of all gas marketed in 1982 was deep gas, the large differential between these prices and those for other categories means that average pipeline acquisitions costs will be significantly influenced by high-cost gas purchase decisions.

Broadman, *supra* note 3, at 9-10.

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted,

JOHN MARSHALL GROWER
(Counsel of Record)
JEFFERSON D. STEWART
R. WILSON MONTJOY, II
BRUNINI, GRANTHAM,
GROWER & HEWES

R. V. LOFTIN, JR.
THOMAS E. SKAINS
DAVID A. GLENN
TRANSCONTINENTAL GAS PIPE
LINE CORPORATION
Attorneys for Appellant

CERTIFICATE OF SERVICE

I, JEFFERSON D. STEWART, do hereby certify that I have caused to be mailed, postage prepaid, a true and correct copy of this Jurisdictional Statement to the following:

Hon. Lloyd Arnold
Office of the Attorney General
Gartin Justice Building
Jackson, MS 39201
Attorney for Mississippi State Oil and Gas Board

Hon. Glenn Gates Taylor
Heidelberg, Woodliff & Franks
Suite 1030 Capitol Towers
Jackson, MS 39201
Attorney for Coastal Exploration Inc.

Hon. Walker L. Watters
Gerald, Brand, Watters, Cox & Hemleben
400 Lamar Life Building
Jackson, MS 39201
Attorney for Getty Oil Company

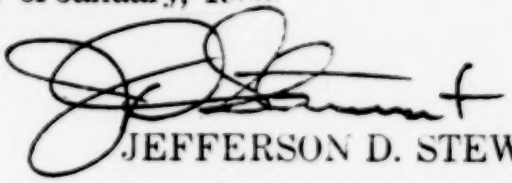
Hon. John Land McDavid
McDavid, Edmonson & Noblin
8th Floor, City Center North
210 S. Lamar Street
Jackson, MS 39201
Attorney for Inexco Oil Company

Hon. William L. Waller, Sr.
Waller & Waller
475 East Capitol Street
Jackson, MS 39201
Attorney for Fairchild Construction Company, Ltd. *et al.*

Hon. Vernon L. Terrell, Jr.
Plauche', Hartley, LaPeyre & Ottinger
Suite 3618 One Shell Square
New Orleans, LA 70139
Attorney for Tomlinson Interests, Inc.

Hon. Robert E. Womack
Clerk of Court
Mississippi Supreme Court
Gartin Justice Building
Jackson, MS 39201

This the 2nd day of January, 1985



JEFFERSON D. STEWART

APPENDICES

APPENDIX A

IN THE SUPREME COURT OF MISSISSIPPI

No. 55,071

TRANSCONTINENTAL GAS PIPE LINE CORPORATION

v.

THE STATE OIL & GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC. *et al*

BEFORE ROY NOBLE LEE, P.J., ROBERTSON, AND SULLIVAN, JJ. ROBERTSON, JUSTICE, FOR THE COURT:

I. INTRODUCTION

This appeal arises out of a controversy regarding well head sales of natural gas produced in Marion County, Mississippi. This litigation has been conducted in the context of tensions created by collisions among basic principles of geology, economics and law when applied in a context where each litigant pursues self-interest.

The geological phenomenon of drainage necessitates, if considerations of fairness undergird our law, a rule that requires that a purchaser of natural gas (generally an interstate pipeline) take ratably from a common source of supply. That purchaser must market that gas, and the advent of deregulation has presented him with new and largely unanticipated difficulties in that regard. The natural gas market has become

glutted. Prices consumers are willing to pay have fallen sharply.

Overlaid upon these tensions are those inherent within our federal system. Until 1978 the federal sovereign indisputably had preempted all state regulation of wellhead sales of natural gas. Today we are presented a question of first impression: whether the Natural Gas Policy Act of 1978 (NGPA) 15 U.S.C. §§ 3301, et seq., continues in effect this federal preemption with respect to wellhead sales of *deregulated* natural gas. A complementary proposition suggests that the regulatory efforts of the State Oil and Gas Board constitute an impermissible burden on interstate commerce proscribed under long-established Commerce Clause jurisprudence.

Below we reject these and other claims advanced under federal law. We find, furthermore, that the State Oil and Gas Board has acted well within its statutory authority in requiring that an interstate pipeline take ratably (if it takes at all) the natural gas produced from a common source of supply.

The State Oil and Gas Board has acted beyond its authority, however, insofar as it has proscribed differentials in wellhead prices. No act of the Legislature of this state authorizes regulation or control of the price paid for natural gas at the wellhead. More specifically, no enactment of the Legislature vests in the State Oil and Gas Board any authority to regulate such prices.

Order No. 409-82 of the State Oil and Gas Board is affirmed in part and reversed in part.

II.

A. The Cast of Characters

The dominant characters, corporate all, before the Court today include:

Transcontinental Gas Pipe Line Corporation (Transco) is a Delaware corporation doing business in Mississippi. Transco is an interstate pipeline company which purchases natural gas from fields in Texas, Louisiana and Mississippi and the federal

off-shore domain. Transco transports this gas from these fields and sells it to customers along its pipeline which extends from southern Texas, through Mississippi, and up the east coast as far as New York. Transco was the principal Respondent before the Oil and Gas Board and is the Appellant here.

Coastal Exploration, Inc. (Coastal) is a Delaware corporation doing business in Mississippi. Coastal is a relatively small in-state oil and gas producer[1] and owns leasehold interests in gas-producing units in Mississippi. Coastal was the lead Petitioner below and is the lead Appellee here.

Tomlinson Interests, Inc. (Tomlinson) is a Texas corporation doing business in Mississippi. Tomlinson is an independent oil and gas producer which operates[2] one of the wells here involved. Tomlinson was one of two Respondents-turned-Petitioner below and is one of the Appellees here.

Getty Oil Company (Getty) is a Delaware corporation doing business in Mississippi. Getty is an oil and gas producer which operates three of the wells here involved. Getty was the other

---

[1]The term "producer" as used in this opinion means the owner of all or part interest in a well or wells capable of producing natural gas. An "owner" may also be a "producer" Miss. Code Ann. § 53-1-3(h) (Supp. 1983); Statewide Rule 2(g), Miss. Oil and Gas Board Rules, promulgated November 19, 1951, effective January 1, 1952.

> The term "Owner" has been defined as any
>
> person who has the right to drill into and produce from any pool, and to appropriate the production either for himself or for himself and another or others. . . .

Miss. Code Ann. § 53-1-3(g) (Supp. 1983); Statewide Rule 2(p), Miss. Oil and Gas Board Rules, promulgated November 19, 1951, effective January 1, 1952.

[2]The term "operator" as used in this opinion means

> any person who, duly authorized, is in charge of the development of a lease or the operation of a producing well.

Statewide Rule 2(r), Miss. Oil and Gas Board Rules, promulgated November 19, 1951, effective January 1, 1952. An "operator" may also be a "producer" or an "owner" or both.

Respondent-turned-Petitioner below and is one of the Appellees here.

Supporting actors, all Petitioners before the Board, include:

Wiley Fairchild and Rodney Fairchild (Fairchilds) are adult resident citizens of Forrest County, Mississippi, each of whom owns an individual working interest in one of the wells here involved.

W. R. Fairchild Construction Company, Ltd. (Fairchilds) is a Mississippi corporation domiciled in Forrest County, Mississippi, and owns an undivided working interest in one of the wells here involved.

Susan W. Clements Lay (Lay) is an adult resident citizen of Hinds County, Mississippi, who owns an undivided working interest in one of the wells here involved.

Lane Petroleum Corporation (Lane) is a Mississippi corporation which owns an undivided working interest in one of the wells here involved.

Louis E. Ridgway, Jr., (Ridgway) is an adult resident citizen of Hinds County, Mississippi, who owns an undivided working interest in one of the wells here involved.

Daniel E. Herlihy (Herlihy) is an adult resident citizen of Hinds County, Mississippi, who owns an undivided working interest in one of the wells here involved.

Bryant M. Allen (Allen) is an adult resident citizen of Hinds County, Mississippi, who owns an undivided working interest in one of the wells here involved.

Inexco Oil Company (Inexco) is a Delaware corporation doing business in Mississippi. Inexco is a small interest owner in four wells here involved.

Of these supporting characters, only the Fairchilds and Inexco took any part in the formal hearing held by the State Oil

and Gas Board, and only Inexco has entered its appearance and filed a brief before this Court. The others are listed because each filed with the Board an informal complaint charging Transco with failure to take ratably.

The State Oil and Gas Board (the Board) is a party to this appeal. The Board is an administrative agency of the State of Mississippi created by virtue of Chapter 256, Miss. Laws of 1948, now codified as Miss. Code Ann. § 53-1-5 (Supp. 1983), authorized in relevant part to make and enforce reasonable rules, regulations and orders protecting against abuse of the correlative rights and opportunities of each owner of oil or gas in a common source of supply and charged with the conduct of hearings such as that held September 14-16, 1982, which has generated Order No. 409-82, the Circuit Court's affirmance of which is here under attack. The Board is an Appellee here.

B. The Drainage Phenomenon

At the core of this case is the geological phenomenon of drainage. That phenomenon has been described by this Court in *Shell Oil Company v. James*, 257 So.2d 488 (Miss. 1972).

> When the pool of oil has been penetrated by a recovery well the oil and gas located in the pool move from a high pressure area to a low pressure area so that the oil and gas migrate from the property of one landowner to another. This exodus is called drainage. 257 So.2d at 494-495.

The phenomenon has been similarly described by the Supreme Court of Kansas in *Northern Natural Gas Company v. State Corporation Commission*, 188 Kan. 355, 362 P.2d 599 (1961):

> While the members of this court make no claim to be experts in the science of the production of natural gas, we believe that the court may take judicial notice of the fact that where natural gas is within the earth in one common source and is under pressure, if one gas well is allowed to take gas, this will result in the pressure being lowered around the vicinity of this gas well so that the gas in the

> common source will tend to drain or rush to the vicinity of the well taking gas. The result will be that the other wells in the common field or source will be able to produce much less gas and the owners of such wells will have suffered a definite loss. 188 Kan. at 358, 362 P.2d at 602

In recognition of the relatively helpless position of the party whose gas is being drained, our law has moved to ameliorate the injustice produced by drainage. Such is the genesis of Statewide Rule 48 promulgated by the State Oil and Gas Board over 30 years ago on November 19, 1951. That rule provides

> RULE 48. Ratable Take.
>
> Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, or producers shall purchase without discrimination in favor of one owner, operator, or producer against another in the same common source of supply.

Questions regarding the meaning, validity and enforceability of Rule 48 are at the center of this case.

Drainage has spawned much litigation in this state. All prior litigation appears to have arisen in the context of one owner of an undivided interest suing another such owner with the plaintiff claiming that the defendant was taking, i.e., draining, the plaintiff's gas. *Shell Oil Company v. James*, 257 So.2d 488, 490 (Miss. 1971); *see generally*, Comment, *Implied Covenant To Protect Leased Premises From Drainage, Etc.*, 35 Miss. L.J. 280, 280-95 (1964) (basis for suits between individuals); Kuntz, *Correlative Rights In Oil and Gas*, 30 Miss. L.J. 1, 1-9 (1958) (same). Insofar as we can ascertain, this is the first time a court of this state has been called upon to consider Rule 48 or in any other context to grant relief against a purchaser of natural gas for drainage loss. *See In Re Petition of Cenard Oil and Gas Co.*, Docket No. 60-64-92, Order No. 81-64, dated April 16, 1964, (Board cited Southern Natural Gas Co. for refusal to take ratably from owners of all interests in common source of sup-

ply; apparently order was not appealed). In this and other contexts, this action plows new furrows.

C. The Background Facts

Greens Creek Field and East Morgantown Field are two natural gas "fields"[3] located in Marion County, Mississippi. Greens Creek Field was discovered by the Harkins and Company—Board of Supervisors Well in 1976. The Harper Sand Gas Pool[4] of that field was first encountered by the Tomlinson Interests, Inc.—J. C. Williamson Well in 1978. Approximately 5 miles south of the J. C. Williamson Well, Tomlinson Interests, Inc. discovered East Morgantown Field, and its Harper Sand Gas Pool, with its Board of Education Well in March, 1979.[5]

These two fields had been defined as separate fields by the Board by late 1980. In 1980, Getty Oil Company discovered

---

[3]The term "field" has been defined in our law as

> the general area which is underlaid or appears to be underlaid by at least one pool; and "field" shall include the underground reservoir or reservoirs containing oil or gas or both. The words "field" and "pool" mean the same thing when only one underground reservoir is involved; however, "field", unlike "pool", may relate to two or more pools.

Miss. Code Ann. § 53-1-3(f) (Supp. 1983); Statewide Rule 2(o), Miss. Oil and Gas Board Rules, promulgated November 19, 1951, effective January 1, 1952.

[4]The term "pool" has been defined in our law as

> an underground reservoir containing a common accumulation of oil or gas or both. Each zone of a general structure which is completely separated from any other zone in the structure is included in the term "pool" as used herein.

Miss. Code Ann. § 53-1-3(e) (Supp. 1983); Statewide Rule 2(n), Miss. Oil and Gas Board Rules, Promulgated November 19, 1951, effective January 1, 1952. The term "pool" is synonymous with "common pool or source of supply" in the Conservation Act's declaration of policy, Miss. Code Ann. § 53-1-1 (Supp. 1983) and with the phrase "same common source of supply" as used in Statewide Rule 48, Miss. Oil and Gas Board Rules.

[5]Reservoir discovery data taken from the Mississippi State Oil and Gas Board Mississsippi Oil and Gas Production Reports for 1978, 1979 and 1980.

additional Harper Sand production directly between these two fields with its Rogers 28-11 Well No. 1.

We now know that the The Harper Sand Gas Pool underlies portions of both the Greens Creek Field and the East Morgantown Field. The two fields are contiguous. If only one well were completed into this pool and natural gas were produced from the pool via that one well, the entire pool would eventually be drained.

At the time of the Board hearing in mid-September, 1982, there were at least six gas wells which had been completed into and which were producing from the Harper Sand Gas Pool: The Getty-Rogers 28-11 Well, the Getty-Sipp 20-9 Well, the Getty-Buckley 33-6 Well (all three operated by Getty), the Tomlinson-Willoughby 3-5 Well (operated by Tomlinson), and the Florida Exploration--Carlisle 4-2 Well and the Florida Exploration-Barnes 29-1 Well (both operated by Florida Exploration Company).

The Harper Sand Gas Pool produced by these wells lies below 15,000 feet. All of the wells producing from this pool have been classified as "deep, high-cost wells" under Section 107(c)(1) of the Natural Gas Policy Act of 1978 (NGPA); 15 U.S.C. § 3317(c)(1).

In 1978, Transco began contracting with producers in Greens Creek Field and, on the basis of those reserves thereby committed, extended its pipeline facilities to that field. When East Morgantown Field was discovered, Transco also began entering into contracts with producers and, as a result thereof, extended its pipeline facilities to those wells to recover the dedicated reserves. Transco entered into additional contracts with producers in 1980 to cover their production where the fields merged.

At the beginning of 1982, Transco had approximately thirty-five different contracts with various owners and producers in these two fields, including Getty and Tomlinson. These contracts had been made at various times between 1978 and 1982

and, because of different market conditions, had substantially different terms and conditions. Prior to July 1, 1982, Transco had not placed any restrictions on the contract owners and producers as to how much gas Transco would take under these contracts.

Coastal owns small undivided working interests (generally less than 1%) in the units of four of the wells which produce from this pool. These are the Rogers, Sipp, Willoughby and Barnes wells. Coastal participated in the drilling of each of these wells, paid its share of drilling and completion costs, and has paid its share of operating costs for each of these wells.

On August 6, 1980, Getty, as the operator and owner of a substantial working interest in the Getty-operated units, entered into a gas purchase contract with Transco. Among the terms of that contract was a price at the wellhead of § 7.907 per one million British thermal units (mmbtu) of gas. When the wells in question first began producing gas in April 1981, beginning with production from the Sipp Well, the gas was sold to Transco.

Many owners (including Coastal) of small undivided interest in the Getty-operated wells had no gas purchase contract when first production began. However, Getty produced all owners' gas and delivered the gas to Transco which in turn purchased and paid for all gas at the same price and on the same terms and conditions as Transco purchased and paid Getty for its gas.

As the other wells completed into the pool began producing, the same procedure was followed, with the effect being that Transco took gas ratably as between the wells producing from the pool.

At the outset of the year 1982, Transco held contracts for the purchase of natural gas from these six wells at prices ranging from a low of $5.00 per mmbtu to a high of $9.054. A representative sampling of those contracts includes:

Contract Number	Date	Seller(s)	Price
06646	09/05/78	Tomlinson Interest, Inc.	6.511 + tax
06690	12/12/78	Harkins & Company	9.054 + tax
06695	12/12/78	First Energy Corporation	"
06696	12/12/78	St. Joe Petroleum (U.S.)	"
06707	12/12/78	Amerada Hess Corporation	"
06991	08/06/80	Getty Oil Company	7.907 + tax
61008	08/22/80	Florida Exploration Company	8.4066 + tax
61045	08/22/80	ACF Petroleum Company	"
61039	11/26/80	Southland Royalty Company	8.065 + tax
61084	03/09/81	Jones O'Brien, Incorporated	8.161 + tax
61218	12/01/81	Sabine Production Company	5.00
61220	01/01/82	Sabine Production Company	5.00

In the spring of 1982, Transco began to experience problems in reselling the gas on its system. As the result of escalating gas costs and declining prices of competing fuel oil, end-use industrial customers of distribution companies served by transco were switching from gas to cheaper fuel oils. By May of 1982, Transco had lost resale markets for approximately 95-100 million cubic feet of gas per day. Because the costs of gas were continuing to rise, Transco projected an additional $.65-$.70 per mmbtu increase in its average cost of gas and thus the inevitable loss of additional markets. Because it was experiencing market loss at its distribution end and was projecting further losses, Transco invoked the "market-out" provisions in all contracts

containing those provisions and began paying those sellers $5.00 per mmbtu.

Coastal Exploration, Inc. had no contract with Transco. Coastal had elected to allow Getty, Florida Exploration, and Tomlinson, the operators of the wells in which it had an interest, to sell its share of gas "under the operating agreement."[6]

In May of 1982, Transco notified Getty and Tomlinson that effective June 1, 1982 (later changed to July 1, 1982), Transco would no longer take or purchase the gas of the "non-contract producers", those owners and producers who had not entered into a gas purchase contract with Transco. However, because of certain provisions of the Florida-Transco gas contract, Transco would continue to purchase non-contract producers' gas produced from the Florida--

---

[6]An operating agreement is the usual means in the oil and gas industry of defining the rights and duties of an operator *vis a vis* the non-operating owners of a well. In this case, every well involved in this dispute was covered by a form operating agreement known as the AAPL Form 610-1977 Model Form Operating Agreement. Of particular interest is the provision in that agreement concerning the sale of gas owned by non-operators:

> Each party shall take in kind or separately dispose of its proportionate share of all oil and gas produced from the contract area, exclusive of production which may be used in development and producing operations and in preparing and treating oil and gas for marketing purposes and production unavoidably lost . . ..
>
> In the event any party shall fail to make the arrangements necessary to take in kind or separately dispose of its proportionate share of the oil and gas produced from the contract area, operator shall have the right, subject to the revocation at will by the party owning it, but no the obligation, to purchase such oil and gas or sell it to others at any time and from time to time, for the account of the non-taking party at the best price attainable in the area for such production. . . . *Any purchase or sale by operator of any other party's share of oil and gas shall be only for such reasonable periods of time as are consistent with the minimum needs of the industry under the particular circumstances but in no event for a period of in excess of one year.* [emphasis added]

operated wells and pay those producers the same price Transco paid Florida.

After receiving this notice from Transco, Getty and Tomlinson notified Coastal that they, as operators, would not produce Coastal's share of gas from the Rogers, Sipp and Willoughby Wells unless Coastal obtained its own gas purchase contract. A similar type notice was sent to other non-contract producers and owners.

Following the notice from Getty and Tomlinson, Coastal attempted to secure another purchaser to whom it could sell its gas but was unsuccessful. In June of 1982, Coastal asked Transco to be allowed to ratify Getty's 1980 contract. Transco refused, unless Coastal would agree to amend the price to $5.00/mmbtu, to add a "market-out clause" (a clause which would allow Transco to adjust the purchase price if the contract price became "uneconomic"), and to nominate a seller's representative. Coastal rejected this offer, at which time Transco refused to take Coastal's gas at all. Coastal then filed its Petition asking the Board to require Transco to purchase its share of gas from the Getty operated wells under the same terms and conditions Transco was purchasing Getty's gas.

Transco did not want or need any more high cost gas because of its market situation. However, in July and August of 1982, it submitted the same offer that it had already made to Tomlinson and Coastal to all non-signatory producers and owners it knew about in Getty and Tomlinson operated wells. The only difference between the 1980 Getty contract and Transco's offer was the pricing provisions and the requirement that they nominate a single seller's representative for each well. At the time of the Board hearing, 55 non-signatory producers and owners in these wells had accepted Transco's offer.

The then-current market value of high cost gas in East Morgantown or Greens Creek Field was no more than what

Transco had offered to the non-signatory producers and owners and was currently paying under its "market out" contracts, *i.e.*, $5.00/mmbtu.[7]

Effective July 1, 1982, as to the Getty-Sipp and Rogers Wells, and effective August 19, 1982, as to the Tomlinson-Willoughby Well, Transco ceased to take gas attributable to the interests of any non-signatory producer or owner in the wells until and unless that producer or owner accepted Transco's $5.00 offer. As a result, Transco's takes of gas and the rates of production from the common pool by these wells were "cut back" to below the maximum efficient rate of flow of the wells.[8] Thereafter, for all practical purposes, the wells produced only and Transco purchased only a rate of production equal to the operators' and other signatory producers' and owners' interests in the maximum efficient rate of flow from the wells.

The situation at the Florida-Carlisle and Barnes Wells, was different, and significantly so. Transco continued to purchase the non-signatory producers' and owners' gas which was produced from these two wells and tendered to Transco by Florida, the operator, on the same terms and conditions and at the same price which Transco paid for Florida's gas. Thus, while the Sipp, Rogers and Willoughby Wells were cut-back to below their respective allowables

---

[7]For a perceptive consideration of the natural gas market today, see Pierce, *Reconsidering The Roles of Regulation And Competition In The Natural Gas Industry*, 97 Harv.L.Rev. 345 (1983); and Pierce, *Natural Gas Regulation, Deregulation and Contracts*, 68, Va.L.Rev. 63 (1982). In the former article, Prof. Pierce documents the statement that "the market for gas would clear today at a price somewhere between four and five dollars". 97 Harv.L.Rev. at 351 (see note 43 and accompanying text).

[8]The Mississippi State Oil and Gas Board determines the maximum *allowable* natural gas withdrawal rates for each gas producing pool. Each well's *allowable* is its "maximum efficient rate of production" as determined by semi-annual deliverability tests made by the operator of each well. See Rule 34(B), Miss. Oil and Gas Board Rules, promulgated November 19, 1951, effective January 1, 1952.

because of Transco's refusal to take and purchase gas, the Barnes and Carlisle Wells continued to be produced at their respective allowables because of Transco's takes and purchases of gas from those wells.

The result of Transco's actions has been and, if allowed to continue, will be non-uniform, disproportionate and unratable withdrawals of gas from the common pool causing undue drainage between tracts of land, that is, drainage and undue drainage *from* the Getty and Tomlinson operated units *to* the Florida operated units producing from the common pool. The result of Transco's actions has also been and, if allowed to continue, will be one or more owners in the common pool producing more than their just and equitable share of the production from the pool.

There is a second form of loss to which the nonsignatory producers and owners will be potentially subject as a result of Transco's actions. If Transco continues to take only the gas it is contractually obligated to take, the remaining gas, though still in the pool, will be much more difficult to retrieve. This is because the pressure in the pool will lower as gas is produced. In this way contracting owners such as Getty will be able to produce more than their just and equitable share of the production from the pool, absent, of course, enforcement of a requirement that contracting owners produce all owners' gas ratably.

It should be noted that Transco was not the only pipeline purchasing gas produced by these wells. Tennessee Gas Pipe Line Co. was also a market outlet for the various owners. The relative percentages in each well under contract first to Transco, then to Tennessee, as well as the interests not under contract are shown on the following table.

Percentage Gas Represented To Be Dedicated Under Gas Purchase Contract

	Transco	Tennessee	WI Owners Who Refused to Sell To Transco & Who Are Still Uncommitted	Balance
Rogers 28-11 (Getty)	45.27489% (14)	2.35040% (8)	33.65260% (2)	18.72211%
Sipp 20-9 (Getty)	70.28732% (33)	9.38427% (17)	11.54930% (1)	8.77911%
Willoughby 3-5 (Tomlinson)	53.14003% (11)	3.40061% (6)	25.66083% (11)	17.79853%
Buckley 33-6 (Getty)	79.95812% (6)	11.34146% (3)	-0- (0)	8.70042%
Carlisle 4-2 (Florida)	63.30590% (4)	29.61460% (9)	1.56250% (1)	5.51700%
Barnes 29-1 (Florida)	65.14900% (4)	11.61600% (11)	-0- (0)	23.23500%

As of the Board hearing in mid-September of 1982, Tennessee was not taking any gas from these six wells. Tennessee had also refused to purchase Coastal's gas. Apparently, Tennessee viewed its market position as Transco did its.

B. Proceedings Below

On July 29, 1982, Coastal commenced these proceedings by filing its petition with the State Oil & Gas Board. Coastal asked

that Transco be required to comply with Statewide Rule 48 by ratably taking gas from the wells producing from the common pool and purchasing without discrimination in favor of the operators, Getty and Tomlinson, against Coastal.

The Fairchilds, owners in the Rogers 28-11 Well, joined in the Petition.

At the hearing before the Board in mid-September 1982, Transco claimed that Statewide Rule 48 was invalid as a matter of state law and that Board had no authority to require Transco to ratably take or purchase without discrimination. Transco argued that federal law had preempted the area and that Rule 48 was unconstitutional for a variety of reasons.

A three day trial was held before the Board during which Transco defended the action by the presentation of witnesses, exhibits and legal arguments, raising as defenses the same claims which it is now asserting before this Court.

On October 13, 1982, the Board ruled in favor of the producers and by its Order No. 409-82 directed Transco to,

> comply with Statewide Rule 48 of the State Oil and Gas Board of Mississippi in its purchases of gas from the East Harper Sand Gas Pool in Greens Creek and East Morgantown Fields and . . . ratably take and purchase gas without discrimination in favor of one owner, operator or producer against another in the said common source of [sic] pool; and, specifically, in the event it so chooses and elects to take and purchase gas from said common pool, Transco shall ratably take and purchase without discrimination in favor of the operators, Getty and Tomlinson against Coastal, the Fairchilds, and Inexco.

Transco, employing Miss. Code Ann. § 53-1-39 (Supp. 1983), appealed to the Circuit Court of the First Judicial District of Hinds County, Mississippi, which on June 28, 1983, released a thorough and competent opinion affirming Order No. 409–82 in its entirety. This appeal has followed. *See* Miss. Code Ann. § 53-1-45 (Supp. 1983).

C. The "Non-Facts"

Before considering the various questions tendered on this appeal, three red herrings need to be disposed of. The facts of this case have been argued as vigorously as the law. Perhaps because much is at stake the parties with more than occasional frequency have reminded us of facts which are of *no* legal significance. These "non-facts" are identified here.

First, nothing here turns on size. That Transco and Getty may be large corporations and that Coastal may be a small corporation simply does not matter. The size of the interest of a party in the various wells is likewise irrelevant. Each party before this Court today stands equal to each other in justice-worthiness.

Second, nothing turns on the domicile of the parties. That some are Mississippians and some are not is of no significance. Today we apply controlling principles of law to relevant facts—and whether a party is Mississippi-based is not among those relevant facts.

Third, the economic consequence of today's decision for one or more of the parties is of no significance, except insofar as the law has provided otherwise. For example, drainage is of serious economic consequence if it occurs and applicable rules of law have given some of these parties protections from it. On the other hand, we have given no thought to whether Transco can sell all the gas it is lawfully required to take, only to the articulation of how much gas Transco is lawfully required to take. Similarly, we have no concern that some non-contract interest owners in the wells in issue may not obtain the return on investment they once expected.

Holmes put the point well in *The Path of The Law*, 10 Harv. L. Rev. 457 (1897)

> The reason why a lawyer does not mention that his client wore a white hat when he made a contract, while Mrs. Quickly would be sure to dwell upon it along with parcel gilt goblet and the sea-coal fire, is that he forsees that the

> public force will act in the same way whatever his client had upon his head. 10 Harv. L. Rev. at 458.

As former lawyers not wanting to appear as Mrs. Quicklys, we advise one and all that the size of the parties and their interests, their states of domicile, and the economic consequences to them of today's decision are of no relevance to our determination how the public force ought act on them.

III. SCOPE OF JUDICIAL REVIEW

We note at the outset the well-settled scope of judicial review of an order of the Oil & Gas Board. The question before the reviewing court is

> whether the order is supported by substantial evidence, is arbitrary or capricious, beyond the power of the Board to make, or violates some constitutional right of the complaining party.

California Co. v. State Oil & Gas Board, 200 Miss. 824, 842, 27 So.2d 542, 546 (1946); *Damson Oil Corp. v. Southeastern Oil Co.*, 370 So.2d 225, 229 (Miss. 1979) (quoting *California Co.*); *Masonite Corp. v. State Oil & Gas Board*, 240 So.2d 446, 448 (Miss. 1970) (same); *Superior Oil Co. v. State Oil & Gas Board*, 220 So.2d 602, 603 (Miss. 1969) (same).

The findings of an administrative agency like the Board are prima facie correct and the reviewing court may not substitute its judgment for that of the administrative agency where there is a substantial basis in the evidence for those findings. *Barnwell, Inc. v. Sun Oil Co.*, 249 Miss. 398, 410-11, 162 So.2d 635, 640 (1964); *State Oil & Gas Board of Mississippi v. Brinkley*, 329 So.2d 512, 515-516 (Miss. 1976); *Masonite Corp. v. State Oil and Gas Board*, 240 So.2d 446, 448 (Miss. 1970); *Damson Oil Corp. v. Southeastern Oil Co.*, 370 So.2d 225, 229 (Miss. 1979).

Well within our authority is a plenary consideration of the claims tendered by Transco based in federal constitutional law, to wit: the claims that Rule 48 and Order No. 409-82 contravene

the Supremacy Clause, the Commerce Clause and the Due Process Clause of the United States Constitution.

Also well within our review authority is a consideration of the question whether Rule 48 or Order No. 409-82, or any part of either, transcends the authority vested by the Mississippi Legislature in the State Oil and Gas Board and is thus beyond the lawful power of the Board to make. Where we find such a transcension, it becomes our responsibility and obligation to declare the offensive portion of the rule or order invalid and unenforceable.

IV. TRANSCO'S CLAIMS UNDER FEDERAL LAW

A. Federal Preemption

The initial thrust of Transco's appeal is that this state's authority to make and enforce a law such as Rule 48 has been effectively preempted by the United States. In Assignment of Error No. 3, Transco says that this preemption has occurred by virtue of the so-called negative Commerce Clause, that long established construction of the Commerce Clause of the Constitution of the United States which limits the authority of the states to enforce unreasonable burdens on interstate commerce. Complementing that argument is the one we consider now, made under Assignment of Error No. 2, to the effect that the Congress, in the exercise of its powers affirmatively granted under the Commerce Clause, has preempted state regulation by virtue of the Natural Gas Act, 15 U.S.C. §§ 717-717w, and the Natural Gas Policy Act of 1978, Pub.L.No. 95-621, 92 Stat. 3352 (1978), codified at 15 U.S.C. §§ 3301 et seq., and the authority and responsibilities vested thereby in the Federal Energy Regulatory Commission (FERC).

The Supremacy Clause of the Constitution of the United States provides that all valid enactments of the Congress shall be the supreme law of the land

> and the Judges of every state shall be bound thereby, anything in the Constitution or Laws of any State to the contrary notwithstanding. U.S. Const. art. VI, § 2.

From this source has sprung the doctrine of federal preemption of state law. Federal law has preemptive effective when the Congress acting within its constitutional powers expressly so provides. *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, ____ U.S. ____, 103 S.Ct. 1905, 1912, 76 L.Ed.2d 1, 13-16 (1983); *Fidelity Federal Savings and Loan Association. v. De La Cuesta*, 458 U.S. 141, 152-53, 102 S.Ct. 3014, 3022-23, 73 L.Ed.2d 664, 674-75 (1982); *Jones v. Rath Packing Co.*, 430 U.S. 519, 525-526, 97 S.Ct. 1305, 1309-1310, 51 L.Ed.2d 604, 613–14 (1977). This Court has respected the preemptive effect of such enactments. *See, e.g., International Association of Bridge, Structural & Ornamental Ironworkers, AFL-CIO Local Union No. 710 vs. Howard L. Byrd Building Service, Inc.*, 284 So.2d 301, 302-303 (Miss. 1973) (federal labor law preempts); *Hattiesburg Building & Construction Trades Council v. Mississippi Mechanical Contractors, Inc.*, 207 So.2d 99, 102-103 (Miss. 1968) (same).

It is now well recognized that state law may be preempted even in the absence of an express congressional enactment to that effect. This view has recently been articulated in *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission*, ____ U.S. ____, 103 S.Ct. 1713, 75 L.Ed.2d 752 (1983), as follows:

> "Absent explicit preemptive language, Congress' intent to supersede state law altogether may be found from a 'scheme of federal regulation so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it,' 'because the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject,' or 'because the object sought to be obtained by federal law and the character of obligations imposed by it may reveal the

> same purpose.' [Citations omitted] Even where Congress has not entirely displaced state regulation in a specific area, state law is preempted to the extent that it actually conflicts with federal law. Such a conflict arises when 'compliance with both federal and state regulations is a physical impossibility,' [Citations omitted] or where state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'
>
> —103 S.Ct. at 1722, 75 L.Ed.2d at 765; *Exxon Corp. v. Eagerton*, ____ U.S. ____, 103 S.Ct. 2296, 2301, 76 L.Ed.2d 497, 505 (1983); *see Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, ____ U.S. ____, 103 S.Ct. 1905, 1912, 76 L.Ed.2d 1, 14-16 (1983) (decision not to regulate can be as preemptive as one to regulate).

The State Oil and Gas Board has attempted to achieve equity and protect owners in a common pool from loss through drainage by the promulgation and enforcement of a rule requiring purchasers at the wellhead to take ratably. Transco, however, argues that Rule 48 as construed and interpreted in Order No. 409-82 regulates an aspect of natural gas production exclusive regulatory jurisdiction over which has been vested by the Congress in FERC. State power, accordingly, has been preempted and, Transco argues, the Circuit Court erred in failing to so hold.

We consider Transco's affirmative preemption claim against the backdrop of our confidence that the State of Mississippi has the authority to regulate the production of natural gas from pools or fields situated within this state. *Superior Oil Co. v. Foote*, 214 Miss. 857, 874-878, 59 So.2d 85, 92-94 (1952). After all, such production is essentially an intra-state (intra-Mississippi) activity. This authority has, generally speaking, been delegated to the State Oil and Gas Board, and constitutionally so. *Barnwell, Inc. v. Sun Oil Co.*, 249 Miss. 398, 406, 162 So.2d 635, 638 (1964). We are concerned here with an authority this state has lest it be preempted by paramount authority emanat-

ing from another sovereign, the United States of America. *Cities Service Gas Company v. Peerless Oil and Gas Company*, 340 U.S. 179, 186-87, 71 S.Ct. 215, 219-20, 95 L.Ed. 190, 202 (1950).

All parties agree that prior to 1978 there existed in the Federal Energy Regulatory Commission (formerly the Federal Power Commission) plenary authority to regulate the sale and transportation of natural gas in interstate commerce. No one questions that prior to 1978 this federal authority within its sphere was more than sufficient to preempt any otherwise lawful state authority. *Northern Natural Gas Co. v. State Corporation Commission of Kansas*, 372 U.S. 84, 89-90, 83 S.Ct. 646, 649, 9 L.Ed.2d 601, 606 (1963). Prior to 1978 this state was without authority to enforce Rule 48 requiring ratable taking, and any order such as Order No. 409-82 would have been wholly *ultra vires*.

In 1978 the Congress enacted and the President signed into law the Natural Gas Policy Act of 1978 (NGPA). 15 U.S.C. §§ 3301, et seq. Transco emphasizes that by virtue of this enactment the Congress extended federal regulation to intrastate gas. This was done to eliminate price discrepancies then existing between intrastate and interstate markets which were encouraging producers to withhold new supplies of gas from the heavily regulated interstate market.

Coastal and the other producers, on the other hand, remind us that the Congress also coupled with that extension of regulation a comprehensive plan of deregulation under which some gas was immediately deregulated, other gas was more gradually deregulated, and regulated gas prices were allowed to escalate, all in order to provide producers, operators and pipeline purchasers with the degree of freedom from regulation and the price incentives necessary to encourage discovery and production of more gas and thus alleviate the theretofore

seemingly perpetual natural gas shortage.[9] We are here concerned only with *deregulated* natural gas.

The Congress specifically found that, under the old Natural Gas Act, FERC (formerly FPC) had kept "just and reason-

---

[9]Prof. Richard J. Pierce, Jr., has described well the basic statutory scheme of the Natural Gas Policy Act of 1978.

> For purposes of deregulation, the NGPA can be considered to have created three major categories of gas. *"High-cost gas," a narrowly defined category that accounts for only a tiny fraction of aggregate gas supply, was deregulated in November 1979.* "New gas," the second category, was subject to price ceilings for various subcategories that resulted in an average price of $2.42 per MMBtu in 1980. These ceilings will increase over time in constant dollars, because most new gas price ceilings will increase at a rate slightly higher than inflation. New gas will be deregulated sometime between 1985 and 1988. "Old gas," the third category, is subject to price ceilings for various subcategories that result in an average price of approximately $1.75 per MMBtu. With the exception of some intrastate old gas that will be deregulated in 1985, old gas will continue to be subject to the same price ceilings in constant dollars indefinitely, because the price ceilings applicable to most subcategories of old gas will increase over time only at the inflation rate.
>
> Under the NGPA, Congress expected deregulation to occur gradually through the following sequence. *First, high cost gas was deregulated in 1979 in recognition of the need for special economic incentives to encourage exploration for and production of high cost gas.* Second, new gas and most intrastate gas is scheduled for deregulation between 1985 and 1988 as the major step in the deregulation process. The annual increase in the price ceiling for new gas was expected to ease the transition to deregulation by permitting the price of new gas to reach approximate parity with the market price of oil by the time of deregulation. Third, although old gas is never scheduled for deregulation, the gas production market is expected to evolve gradually into a totally unregulated market as old gas becomes less of a factor in the aggregate national gas supply. Old gas subject to continuing price ceilings is expected to account for only about one-half of aggregate supply in 1985, with its proportional contribution to national supply diminishing every year. [Emphasis added]

Pierce, *Natural Gas Regulation, Deregulation and Contracts*, 68 Va. L. Rev. 63, 87-89 (1982); *see also*, Pierce, *Reconsidering The Roles of Regulation And Competition In The Natural Gas Industry*, 97 Harv. L. Rev. 345, 348-350 (1983). As explained above, all of the gas with which we are here concerned is deregulated high cost gas, de facto as well as de jure.

able" wellhead sales prices of gas artificially low and had imposed a regulatory maze upon such sales so that production for sale in the interstate market was effectively deterred, all contrary to the national interest in having ready access to an adequate supply of natural gas. *Tenneco, Inc. v. Sutton*, 530 F.Supp. 411, 420 (M.D.La. 1981).

However important the congressional policy and context may be, our precise question today is whether - following enactment of NGPA - federal preemption (with respect to deregulated high cost gas) which undoubtedly existed theretofore continued. Transco argues vigorously that FERC jurisdiction still exists (although in altered form), and that preemption under *Northern Natural* remains the order of the day. Coastal and the other producers candidly pose the issue

> "We will not mince words: if the "first sale" (the wellhead sale) of deregulated gas continues to be subject to FERC's jurisdiction under Section 1(b) of the NGA, then *Northern Natural* applies to this case and Order No. 409-82 is invalid."
>
> —(Brief of Coastal Exploration, Inc., served November 29, 1983, at 22)

Northern Natural held invalid a ratable take order which the Kansas Corporation Commission had entered against an interstate pipeline company. The basis of the decision was state's invasion of the FPC's exclusive regulatory jurisdiction under Section 1(b) of the Natural Gas Act of 1938:

> "We disagree with the Kansas Supreme Court, for we hold that the State Commission's orders did invade the exclusive jurisdiction which the Natural Gas Act has conferred upon the Federal Power Commission over the sale and transportation of natural gas in interstate commerce for resale."
>
> —372 U.S. at 89, 83 S.Ct. at 649, 9 L.Ed.2d at 606.

It is our reading of the Natural Gas Policy Act of 1978 that wellhead sales of the sort of gas with which we are here con-

cerned have been effectively deregulated. We are concerned here with high cost natural gas, 15 U.S.C. § 3317(c) (1), which as a matter of law is no longer subject to FERC (formerly FPC) jurisdiction. 15 U.S.C. § 3431(a) (1) (B) (i). Congress has declared that the first sale of deregulated gas is never made subject to the Natural Gas Act or to FERC's jurisdiction under that act, and "dedicated gas" which is determined to be deregulated gas ceases to be subject to the NGA or FERC's jurisdiction under the NGA. With respect to this category of gas, the regulatory situation existing at the time *Northern Natural* was decided has thus been altered radically.

NGPA Section 601(a) (1) (A), (B) and (D), 15 U.S.C. § 3431(a) (1) (A), (B) and (D), provide as follows:

SECTION 601. COORDINATION WITH THE NATURAL GAS ACT—

(a) JURISDICTION OF THE COMMISSION UNDER THE NATURAL GAS ACT.—

(1) SALES.—

(A) NATURAL GAS NOT COMMITTED OR DEDICATED—*For purposes of section 1(b) of the Natural Gas Act*, effective on the first day of the first month beginning after the date of the enactment of this Act, *the provisions of the Natural Gas Act and the jurisdiction of the Commission under such shall not apply to natural gas which was not committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act* solely by reason of any first sale of such natural gas.

(B) COMMITTED OR DEDICATED NATURAL GAS—Effective beginning on the first day of the first month beginning after the date of the enactment of this Act, *for purposes of section 1(b) of the Natural Gas Act, the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed*

> *or dedicated to interstate commerce as of the day before the date of the enactment of this Act and which is—*
>
> (i) *High-cost natural gas* (as defined in Section 107(c)(1), (2), (3), or (4) of this Act); [Emphasis added].

The "Joint Explanatory Statement of the Committee on Conference" of the Congress, which accompanied the NGPA, makes clear what the conferees intended that Section 601(a) (1) accomplish.

> "The Conference Agreement limits the jurisdiction of the Commission under the Natural Gas Act in a manner similar to the House-passed bill. Natural gas not committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act is never made subject to the Commission's jurisdiction under sec. 1(b) of the Natural Gas Act. The Commission's jurisdiction under section 1(b) of the Natural Gas Act ceases on the first day of the first month beginning after the date of enactment of this Act for the following categories of natural gas:
>
> High-cost natural gas which qualifies for deregulated price treatment under section 107(c) (1), (2), (3), or (4); [Emphasis added].
>
> * * *

Section 601(a) (1) [15 U.S.C. § 3431(a) (1)] means what it says—the Natural Gas Act of 1938 (NGA) and FERC's jurisdiction under the Act *never* apply to deregulated gas, and certain other categories of gas. That message is decisive of the preemption issue in this case. The reason the Supreme Court voided the ratable take order in *Northern Natural* was because at that particular point in time such an order substantially affected gas which was subject to the FPC's (FERC's) jurisdiction under the NGA. If the NGA and FERC's jurisdiction under the NGA no longer extend to deregulated gas, and FERC has no authority to regulate the first sales and purchases of deregulated gas either directly or indirectly, then *Northern Natural* does not dictate a preemption of otherwise existing state authority.

We are not unmindful of the fact that FERC still has the authority to determine whether pipelines such as Transco may "pass through" the prices they pay at the wellhead, although pass through may be denied only where FERC "determines that the amount paid [by the pipeline] was excessive due to fraud, abuse or similar grounds". 15 U.S.C. § 3431(c) (2). Transco cites this continuing pass through approval authority and urges that FERC jurisdiction continues, only FERC now regulates by reference to a "fraud and collusion" standard as distinguished from the old "just and reasonable" standard. A change in the standard, Transco argues, does not alter the de jure existence of jurisdiction the effect of which is preemption.

The argument is disingenuous. FERC to be sure has today authority to prohibit a pipeline from passing through to consumers excessive wellhead prices paid producers as a result of some nefarious scheme to defraud a consumer. But FERC has no authority to intervene when the pipeline, denied pass through, seeks to get out of its deal with the producers. Though the price paid at the wellhead may well be FERC-determined excessive as the product of fraud or collusion when pass through is sought, it remains a just and reasonable price *as a matter of law* as between the pipeline and the producer. 15 U.S.C. § 3431(b) (1) (A). Nothing in the pass through provisions of NGPA continues in effect any FERC jurisdiction over wellhead first sales of deregulated natural gas.

Our review of the congressional enactments discloses no explicit preemptive language. Our comparison of Rule 48 with federal law reveals no point of actual conflict. Transco's compliance with Rule 48 would not cause it to act in violation of the spirit or letter of any federal law. Finally, we find nothing in federal law as modified by NGPA which leaves in place a "scheme of federal regulation so pervasive as to make reasonable the inference that Congress left no room for the states to supplement it." *Fidelity Federal Savings & Loan Assn. v. De La Cuesta*, 458 U.S. 141, 153, 102 S.Ct. 3014, 73 L.Ed.2d 664, 675 (1982). As presently constituted federal law fails to generate any spirit, policy or rule with which a natural gas producing

state would collide if it sought to do equity between and among owners in a common pool of deregulated gas by the promulgation or enforcement of a common purchaser or ratable take rule.

Our conclusion that federal jurisdiction and regulation, both the expressed and implicit varieties, have been withdrawn does not *ipso facto* leave the state free to reenter, for

> "a federal decision to forgo regulation in a given area may imply an authoritative federal determination that the area is best left *un*regulated, and in that event would have as much pre-emptive force as a decision *to* regulate."
>
> —*Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, ____U.S.____, 103 S.Ct. at 1912, 76 L.Ed.2d at 10 (emphasis in original).

This notion must be taken seriously here. Our context is a congressional fact finding that regulation and price controls, however well intended, have had an effect contrary to the national interest.[10] The Congress has found that regulation of the sale and transportation of natural gas in interstate commerce has had the effect of stifling production for the interstate market. The Congress determined that the national interest would be served in the long run by a different approach, that first sales—wellhead sales—should be deregulated and that the inevitably increased cost of production should be borne by the consumer.

In this context, the Congress certainly had the authority to enact not only a federal plan of deregulation of first sales but also that these sales should be free of state regulation. If federal regulation produces evils inimicable to the national interest, a plethora of state regulations varying from jurisdiction to jurisdiction seems equally capable.

---

[10]See Pierce, *Natural Gas Regulation, Deregulation and Contracts*, 68 Va.L.Rev. 63, 69-72 (1982); and Pierce, *Reconsidering the Roles of Regulation And Competition In The Natural Gas Industry*, 97 Harv.L.Rev. 345, 371-372 (1983).

Our study of the terms and provisions of the Natural Gas Policy Act of 1978, however, convinces us that the Congress has not proscribed state regulation of wellhead sales of deregulated gas. However consistent a continued proscription on state regulation might have been with the theoretical underpinnings of deregulation, the Congress in NGPA in 1978 did not ban state regulation of deregulated gas. What, and all, the Congress has done insofar as we are concerned is strip away federal regulatory authority thus leaving in effect and wholly exercisable such state regulatory authority as otherwise exists. The lynchpin that holds *Northern Natural* together having been removed, and not having not been replaced by a congressional enactment that wellhead prices of deregulated gas be left unregulated by the states as well, Transco's preemption claim fails. The states today have the authority to require that an interstate pipeline company take deregulated gas ratably and without discrimination in favor of one owner, operator or producer and against another in the same common source of supply. *Cities Services Gas Co. v. Peerless Oil & Gas Company*, 340 U.S. 179, 185, 71 S.Ct. 215, 219, 95 L.Ed. 190, 201 (1950) Transco's Assignment of Error No. 2 is denied.

A caveat: Today's facts and today's holding concern "deregulated gas". The Harper Sand Gas Pool lies at a depth of more than 15,000 feet below the surface of the earth. The wells in issue produce "high-cost natural gas", 15 U.S.C. § 3317(c) (1), with respect to the wellhead sales pricing of which FERC has no jurisdiction. 15 U.S.C. § 3431(a) (1) (B) (i). The first sales of many other categories of natural gas remain subject to FERC jurisdiction and regulation according to NGPA. Nothing said here, of course, can decide any preemption question that may hereafter arise in the context of regulated natural gas produced in this state.

B. The Negative Commerce Clause

By virtue of the Constitution's having vested the Congress of the United States with the power to regulate commerce among

the states, U.S. Const., art. I, § 8, cl. 3, Transco argues via Assignment of Error No. 3 that the State of Mississippi is without authority to enforce Rule 48 as interpreted in Order No. 409-82 because it creates an impermissible burden on interstate commerce.

Grammatically speaking, the Commerce Clause is an affirmative grant of power to the Congress. A century and a half of constitutional decisional jurisprudence, traceable to a dictum by Chief Justice Marshall in *Gibbons v. Ogden*, 22 U.S. (9 Wheat) 1, 209, 6 L.Ed. 23, 73 (1824), have established the legitimacy and reality of the negative Commerce Clause. Even in the absence of exercise by the Congress of its power to regulate commerce, the clause stands as a barrier to the enforcement by the states of laws, statutes or regulations which unreasonably discriminate in favor of in-state interests.

The values undergirding the negative Commerce Clause were articulated by Justice Robert H. Jackson on *H. P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 69 S.Ct. 657, 93 L.Ed. 865 (1949).

> "Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his export, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any."
>
> —336 U.S. at 539, 69 S.Ct. at 665, 93 L.Ed. at 875.

The Commerce Clause is said to create a national common market. Individual business entities are free to operate commercially in any state where such operations are legal and may not be denied access to markets or resources based upon that choice. Conversely, a buyer's state of origin generally should not affect his access to goods produced anywhere in the coun-

try. The states are without authority to enforce laws imposing substantial burdens on such consumer. *South-Central Timber and Development, Inc. v. Wunnicke*, ____ U.S. ____, 104 S.Ct. 2237, 2247, 81 L.Ed.2d 71, 76 (1984); *Hughes v. Oklahoma*, 441 U.S. 322, 326, 99 S.Ct. 1727, 1731, 60 L.Ed.2d 250, 255-56 (1979); *H. P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 534-538, 69 S.Ct. 657, 663-64, 93 L.Ed. 865, 872-74 (1949); *Cooley v. Board of Wardens*, 53 U.S. (12 How.) 299, 319, 13 L.Ed. 996, 1004-05 (1851).

Any regulation of a business enterprise engaged in interstate commerce has *some* effect on commerce among the states. This is undoubtedly so in the case of Rule 48 and Order No. 409-82. The question is not whether the state's regulations impose a burden on interstate commerce but whether the burden which is imposed is a constitutionally impermissible one.

Just how much of a burden upon interstate commerce must be found before a state runs afoul of the negative Commerce Clause has been a subject of long debate and varying answers by the Supreme Court. This has particularly been so in the past decade or so as the Supreme Court has muddled its way along through the quagmire of a conceptually pleasing but practicably nightmarish (at least from the point of view of achieving rationally consistent results from case to case and thus affording the needed tools to states and citizens concerned with predictability) balancing of interests test first announced in *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 90 S.Ct. 844, 25 L.Ed.2d 174 (1970). In *Pike* the Supreme Court articulated what has become the contemporary formulation of the negative Commerce Clause as applied to a state's attempt to regulate interstate commerce.

> Although the criteria for determining the validity of state statutes [regulations, rules or orders] affecting interstate commerce have variously stated, the general rule that emerges can be phrased as follows: where the statute [regulation, rule or order] regulates even-handedly to

> effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. [citation ommitted] If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate commerce."
>
> —397 U.S. at 142, 90 S.Ct. at 847, 25 L.Ed.2d at 178-79.

We have been authoritatively instructed in this formulation of the negative Commerce Clause in *Great Atlantic and Pacific Tea Co. v. Cottrell*, 424 U.S. 366, 371-372, 96 S.Ct. 923, 928, 47 L.Ed.2d 55, 61 (1976). In that case the Supreme Court, reversing a decision of this Court, applied the balancing of interests test and invalidated a Mississippi restriction on the sale of milk as this state had sought to enforce it against a Louisiana milk producer.

A review of the dozens of decisions since *Pike v. Bruce Church*, wherein the established formulation has been rotely recited, produces little in the way of doctrinal consistency or easily rationalized results. Just what is "a legitimate public purpose" and how much of one need exist before a state regulation will be sustained seems almost to depend on who is doing the looking and what that justice had for breakfast on the day of decision; the same with whether the inevitable burden on interstate commerce is "only incidental" or is "clearly excessive".

In the first years of litigation under the new balancing test, the Supreme Court seemed relatively easily satisfied that a burden was excessive and relatively hard to convince that the state did not have a nondiscriminatory alternative adequate to protect local interests. *See Hughes v. Oklahoma*, 441 U.S. 322, 339, 99 S.Ct. 1727, 1737-38, 60 L.Ed.2d 250, 263 (1979) (statute invalid that forbid export of minnows); *Hunt v. Washington*

State Apple Advertising Commission, 432 U.S. 333, 353, 97 S.Ct. 2434, 2446-47, 53 L.Ed.2d 383, 400-01 (1977) (statute invalid that mandated apples be ungraded); *Great Atlantic and Pacific Tea Co. v. Cottrell*, 424 U.S. at 377, 96 S.Ct. at 931-31, 47 L.Ed.2d at 64 (1976) (Mississippi statute invalid that prohibits importing milk from another state unless that state allows Mississippi milk to be imported).

More recent cases give the states wider berth. *See, e.g., Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, ____U.S.____, 103 S.Ct. 1905, 1917-18, 76 L.Ed.2d 1, 16-18 (1983) (state commission could govern wholesale electric rates); *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 471-73, 101 S.Ct. 715,727-29, 66 L.Ed.2d 659, 673-75 (1981) (state could ban sale of milk in plastic containers); *Reeves, Inc. v. Stake*, 447 U.S. 429, 443-47, 100 S.Ct. 2271, 2281-82, 65 L.Ed.2d 244,255-57 (1980) (state could limit sale of state-owned cement to residents); *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 127-29, 98 S.Ct. 2207, 2214-15, 57 L.Ed.2d 91, 101-02 (1978) (state could mandate that oil producers not own retail outlets). The same permissive trend is also discernible in recent state taxation of interstate commerce cases, arguably decided via a different doctrinal formulation. *See, e.g., Commonwealth Edison v. Montana*, 453 U.S. 609, 624-29, 101 S.Ct. 2946, 2957-59, 69 L.Ed.2d 884, 898-902 (1981) (state could place exorbitant severance tax on coal); *Complete Auto Transit Co. v. Brady*, 430 U.S. 274, 288-89, 97 S.Ct. 1076, 1083-84, 51 L.Ed.2d 326, 336-37 (1977) (upholding a tax imposed by this state against an interstate trucking company for the privilege of doing business within this state).

One concern arising from the ad hoc interpretation of the negative Commerce Clause is the authoritative effect of pre-*Pike* decisions. We express this concern in the context of Transco's insistence that one of the burdens upon interstate commerce created by the rule and order here in issue is increased prices to the consumer. Pre-*Pike* decisions, however, establish that increased prices or decreased supplies to consumers in other states do not necessarily render a state's

regulation unconstitutional. *Cities Service Gas Co. v. Peerless Oil and Gas Co.*, 340 U.S. 179, 186-87, 71 S.Ct. 215, 219-20, 95 L.Ed. 190, 202-03 (1950) (state could order pipeline to ratably take sellers gas at fixed price); *Parker v. Brown*, 317 U.S. 341, 368, 63 S.Ct. 307, 322, 87 L.Ed. 315, 335-36 (1943) (state could control raisin marketing); and *Milk Control Board v. Eisenberg Farm Products*, 306 U.S. 346, 352-353, 59 S.Ct. 528, 530-31, 83 L.Ed. 752, 756-57 (1939) (state could set minimum price paid to milk producers). With some temerity, we assume that the premise derived from these cases is still good law.

In this context, *Pike v. Bruce Church, Inc.* directs that we proceed to a consideration of what legitimate local interests may be said to undergird and be promoted by Rule 48 and Order No. 409-82.

Coastal, Getty and the other producers argue that conservation of an important natural resource and the prevention of waste are implicated. Without doubt, if this were so, such would be a legitimate local interest entitled to great weight and consideration in the Commerce Clause balancing test. It is difficult, however, for us to see how there is waste of natural resources when an interstate pipe line company refuses to take ratably or otherwise. Waste would seem to follow from taking too much, not too little.

We are aware of the statutory definition of waste. Miss. Code Ann. § 53-1-3(k) (Supp. 1983). How our Legislature defines waste for purposes of the Mississippi Conservation Act, of course, is its prerogative. *Compare Stong, Administratrix v. Freeman Truck Line, Inc.*, ____ So.2d ____, ____ (Miss. 1984); *McLaurin v. Mississippi Employment Security Commission*, 435 So.2d 1170, 1171-1172 (Miss. 1983). Its definition, of course, is in no way controlling for purposes of analysis under the Commerce Clause of the Constitution of the United States.

The true and entirely legitimate local interest here implicated is fairness. Rule 48 is a rule of equity. The drainage phenomenon is a fact of life of natural gas production. *Shell Oil Company v. James*, 257 So.2d 488, 494-495 (Miss. 1971). The

state through its Oil and Gas Board has acted in this and other ways to assure equity and fairness between and among the varying interests in a common source of supply. *See Phillips Petroleum Co. v. Millette*, 221 Miss. 1, 15-17, 72 So.2d 176, 179 (1954) (protection against loss through drainage required by fundamental notions of equity and justice).

We regard fairness as among the more noble purposes of the state. It is a fundamental component of the idea of justice. Rawls, *A Theory of Justice* (1971). That we are concerned here with the distribution of material and highly valuable resources does not denigrate or render less noble the state's duty to assure fairness between all persons affected. A laudable feature of Rule 48 in the present context is that it applies to owners of interests in the common source of supply without reference to whether they be Mississippians. Getty is entitled to the same fair treatment as is Coastal as are the Fairchilds as is Tomlinson and as is Inexco and so forth.

Transco argues that the principal burden upon interstate commerce resulting from Rule 48 and Order No. 409-82 is higher prices to the ultimate purchasers and consumers of natural gas. The argument is not persuasive.

First, as indicated above, we believe the proposition well-established that higher prices to consumers in another state do not render a state's regulation of commerce impermissible per se under the negative Commerce Clause. *Cities Service Company v. Peerless Oil and Gas Co.*, 340 U.S. 179, 186-87, 71 S.Ct. 215, 219-20, 95 L.Ed. 190, 202-03 (1950); *Parker v. Brown*, 317 U.S. 341, 368, 63 S.Ct. 307, 322, 87 L.Ed. 315, 335-36 (1943); *Milk Control Board v. Eisenberg*, 306 U.S. 346, 352-353, 59 S.Ct. 5[illegible], 530-31, 83 L.Ed. 752, 756-57 (1939).

Second, the Congress has declared that all reasonable costs of production of natural gas shall be borne ultimately by the consumer. This is one of the fundamental policy determinations underlying the Natural Gas Policy Act of 1978. Indeed, it was assumed by Congress that prices to the consumer would increase. This was found preferable to the pre-existing price

controls and regulatory policies of FERC under the pre-1978 Natural Gas Act. Thus, whether increased prices to consumers may be fairly characterized as an incidental burden upon interstate commerce, we find it persuasive that Congress within the scope of its power under the affirmative Commerce Clause has expressly authorized such increases.

Transco further argues that there is a burden on interstate commerce emanating from Rule 48 in that compliance with Order No. 409-82 will require that more natural gas be taken from Mississippi and less from Louisiana and Texas. The quick answer is that Louisiana and Texas also have ratable take regulations in effect.[11] Furthermore, no evidence has been adduced which would lend credence to Transco's argument that Rule 48 impermissibly discriminates against natural gas production in Louisiana and Texas.

The fundamental flaw in Transco's reasoning on the burden point is that it seems to be talking much more about a burden upon Transco than a burden upon interestate commerce. The burden upon Transco appears traceable to its contract with Getty, not to Rule 48. That contract is one Transco freely and voluntarily entered with Getty. It is hard to see how a ratable take rule or order could be said to generate an unreasonable burden on interstate commerce when the only thing requiring Transco (or any other interstate pipeline) to take at all, ratably or otherwise, is its own contract.

Many important provisions of that contract reflect that the parties carefully considered future eventualities. The so-called take-or-pay provision obligating Transco to pay whether it takes the production made available by Getty is one such

---

[11]Other natural gas producing states have comparable ratable take regulations sometimes referred to as "common purchaser" statutes. Kan. Stat. Ann. § 55-703 (Supp. 1983) (Kansas); La. Rev. Stat. Ann. § 30:42 (West Supp. 1984) (Louisiana); Neb. Rev. Stat. § 57-907 (1979) (Nebraska); N.M. Stat. Ann. § 70-2-19 (Supp. 1984) (New Mexico); N.D. Cent. Code § 49-19-07 (1978) (North Dakota); Okla. Stat. Ann. tit. 52, § 23 and 233 (West 1969) (Oklahoma); Tex. Nat. Res. Code Ann. § 11.083 (Vernon 1978) (Texas).

clause. Transco's problem is that it failed to protect itself against the market glut and declining prices consumers are willing to pay for natural gas. It is not now and never has been the function of this Court to relieve a party to a freely negotiated contract of the burdens of a provision which becomes more onerous than had originally been anticipated. *Bunting v. Orendorf*, 152 Miss. 327, 332, 120 So. 182, 183 (1929); *Jemison v. McDaniel*, 25 Miss. 83, 86 (1852); *Gulf Oil Corp. v. Federal Power Commission*, 563 F.2d 588, 598-600 (3d Cir. 1977).

Not only did Transco freely and voluntarily—and no doubt in anticipation of accomplishing its own advantage—enter into the contract with Getty in 1980, it did so against the backdrop of Rule 48. One Transco official admitted actual knowledge of Rule 48. In any event, an interstate pipeline such as Transco is chargeable with full knowledge of Rule 48 and any other applicable state regulations (or statutes, laws, etc.) existing at the time of contracting. The parties contract against the backdrop of regulation and ought generally be held to an implied incorporation of applicable regulations into the contract.

Transco's argument that Rule 48 had never been enforced is lame indeed. Transco knew of the existence of the rule or was certainly charged with knowledge of its existence; the rule has been on the books since 1952. Despite the argument made here, Transco was chargeable with knowledge that the states became entitled to play a greater role in regulation of the production of deregulated natural gas following enactment of the Natural Gas Policy Act in 1978. More fundamentally, Transco was certainly aware of the drainage problem inherent in natural gas production when there are two or more wells producing from a common source of supply, thus necessitating a rule something like Rule 48 to assure equity and fairness amongst the owners of the various interests in the common pool.

Transco has the right to pass the costs it incurs in purchasing natural gas through to the consumer. 15 U.S.C., § 3431(c). In this sense, it is not Transco who experiences a burden, it is the

consumer. If higher purchasing prices at the wellhead lead to higher prices to the consumer and a loss of markets, this is simply one inevitable consequence of the free market policies of the era of deregulation with respect to which Transco is vested by the negative Commerce Clause with no right to complain.

A final point by Transco here is that the state had a less discriminatory alternative adequate to protect local interest, i.e., a ratable production order as distinguished from a ratable take order. To be sure, one inquiry under the *Pike v. Bruce Church* balancing test is whether there are available to a state less discriminatory alternatives adequate to protect the local interests implicated, and the Supreme Court has made it clear that this inquiry must be taken seriously. *Hughes v. Oklahoma*, 441 U.S. at 339, 99 S.Ct. at 1737, 60 L.Ed.2d at 263; *Hunt v. Washington State Apple Advertising Commission*, 432 U.S. at 353, 97 S.Ct. at 2446-47, 53 L.Ed.2d at 400-01; *Great Atlantic and Pacific Tea Co. v. Cottrell*, 424 U.S. at 377, 96 S.Ct. at 930-31, 47 L.Ed.2d at 64.

The search for such alternatives, however, need not be made in connection with our Commerce Clause inquiry until it first be established that the regulation in question creates an unreasonable burden on commerce. This Transco has failed to do—for as explained above, the burdens are on Transco, not interstate pipe lines generally, because only Transco has, wittingly or unwittingly, bound itself to a long term, fixed price gas purchase contract. When that contract is taken out of the case, it is seen that the so-called burdens of Rule 48 disappear.

The point is made crystal clear by Transco's present policy of insisting upon "market-out" provisions in its contract—provisions which allow the price Transco pays to the producer to fluctuate with market price to the consumer. If Transco had negotiated a market-out clause in its contract with Getty, these proceedings no doubt would not be before this Court today.

In summary, we hold that the State of Mississippi via its Oil and Gas Board had the authority to promulgate and has the authority to enforce Statewide Rule 48. Nothing in Rule 48 or

its interpretation in Order No. 409-82 contravenes the authority remaining vested in the State of Mississippi once its authority to regulate commerce has been effectively restricted by the negative Commerce Clause. Transco's Assignment of Error No. 3 is rejected.

C. Void-For-Vagueness

Under Assignment of Error No. 4, Transco argues that Rule 48 is void for vagueness. The claim is predicated upon rights said to be vested in Transco by virtue of the Due Process Clause of the Fourteenth Amendment to the Constitution of the United States.

It is the foremost requisite of a legal system that there be general rules. Where those rules are not made clear and are not published and available to persons in the planning of their economic and social activities, the efficacy of the system is in substantial danger. Fuller, *The Morality of Law*, 46-51, 63-70 (rev. ed. 1969).

These notions have acquired constitutional status. *Connally v. General Construction Co.*, 269 U.S. 385, 46 S.Ct. 126, 70 L.Ed. 322 (1925) states

> "[A] statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application violates the first essential of due process."
>
> - 269 U.S. at 391, 46 S.Ct. at 127-28, 70 L.Ed. at 328.

An unconstitutionally vague statute or regulation is unenforceable. *A. B. Small Co. v. American Sugar Refining Co.*, 267 U.S. 233, 242, 45 S.Ct. 295, 298, 69 L.Ed. 589, 594-95 (1924).

Most of the void for vagueness cases have arisen in the context of criminal prosecutions. *See ABC Interstate Theatres, Inc. v. State*, 325 So.2d 123, 125 (Miss. 1976) (obscenity statute overbroad). It is clear, however, that the doctrine applies to

civil statutes and to regulations. *See A. B. Small Co. v. American Sugar Refining Co.*, 267 U.S. at 237, 45 S.Ct. at 296, 69 L.Ed at 592 (applied to civil statute); *Hynes v. Mayor of Oradell*, 425 U.S. 610, 620, 96 S.Ct. 1755, 1760, 48 L.Ed.2d 243, 253, (1976) (applied to regulation). On the other hand, when the doctrine is applied in the context of economic regulation its strictures are relaxed. *Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 498, 102 S.Ct. 1186, 1192, 71 L.Ed.2d 362, 371-372 (1982).

A rule or standard is not objectionable merely because it is stated in general terms and is not susceptible of precise application. Familiar examples of such general standards abound in our law, *e.g.*, negligence, unconscionability, fraud. We doubt anyone would seriously argue today that these standards are unconstitutionally vague.

Transco focuses its attack upon three aspects of Rule 48. These are (a) "ratable take", (b) "purchase without discrimination", and (c) "same common source of supply". We find these terms readily understandable. Transco's brief demonstrates that they are not susceptible of precise mechanical application, but what law is?

Ratable take suggests a general rule of equity. The phrase refers to the taking of an amount of gas from one well such that the percentage of said amount to the well's allowable is the same as the percentage that the amount taken from a second well bears to the allowable for the second well. Ratable taking connotes fairness. Its synonym is "pro-rata". *HBOP, Ltd v. Delhi Gas Pipe Line Corporation*, 645 P.2d 1042, 1046 n.9 (Okla. Ct. App. 1982).

The concept as we understand it refers to production. It refers to the percentage of allowable production of a common source of supply. It also refers to equity between interests in a given pool. It means that the party "taking" must take pro-rata with respect to the relative interests, percentage-wise, the various owners have in the pool. That the concept is general hardly establishes that it is impermissibly vague.

The phrase "purchase without discrimination' imparts the same meaning. At the risk of being repetitious, purchase without discrimination means to purchase or acquire pro-rata from a given pool the same percentage of one owner's interest as is purchased of another owner's interest. It likewise means, within a given pool or common source of supply, that the party purchasing will purchase the same percentage of one well's allowable as is the case with respect to all other wells in the pool or common source of supply.

We pause here to note that a central question in this case is whether Transco may purchase without *price* discrimination with respect to the varying interests in the six wells said to be in a common source of supply. As we explain below, the Legislature has not vested the Oil and Gas Board authority to proscribe price discrimination or to inaugurate any other form of regulation of the prices of wellhead sales of natural gas. This is not to say that the Legislature could not endow the Oil and Gas Board with such authority, if it rationally determined that such was consistent with the public interest. We simply hold today that it has not yet done so.

Finally, Transco challenges as vague the term "common source of supply". This one gives us no trouble. The term simply refers to that geological configuration or area within which a significant drainage problem would result if there be unratable taking from one well to another. It is synonymous with "pool"[12]

The Supreme Court of the United States has decided that a state ratable take order, although couched in general language, presents no constitutional infirmities regarding vagueness. *Phillips Petroleum Company v. Oklahoma*, 340 U.S. 190, 192, 71 S.Ct. 221, 222, 95 L.Ed. 204, 206-07 (1950). We do not regard *Corporation Commission v. Champlin Refining Co.*, 286 U.S. 210, 242-243, 52 S.Ct. 559, 567-68, 76 L.Ed. 1062, 1082-83 (1931) as being to the contrary. Assuming arguendo that

---

[12]*See supra* note 4.

Champlin is to the contrary, it has been in part overruled by more recent decisions.

D. Taking Without Compensation

Transco next argues that Order No. 409-82 is an arbitrary and unreasonable exercise of the state's police power and, if enforced, would result in a taking of Transco's property without compensation in violation of the Due Process Clause of the Fourteenth Amendment to the Constitution of the United States.

It may be true that a taking of private property by governmental action violates the owner's due process rights if the action bears no reasonable relation to a legitimate governmental purpose or is otherwise arbitrary. *Thompson v. Consolidated Gas Utilities Corp.*, 300 U.S. 55, 70, 57 S.Ct. 364, 371, 81 L.Ed. 510, 518 (1936). Here, however, we have a legitimate governmental purpose. The state has a completely legitimate interest, as articulated in the policy statement of the Conservation Act, to

> "safeguard, protect and enforce the co-equal and correlative rights of owners in a common source or pool of oil and gas to the end that each such owner in a common pool or source of supply of oil and gas may obtain his just and equitable share of production therefrom."

As discussed previously, it is Transco's contract with Getty - not Rule 48 - which effects a "taking" of Transco's property. This sort of "taking" is colloquially known as "business".

We reject out-of-hand Transco's argument that Order No. 409-82 constitutes an impermissible taking of private property without compensation and in so doing we complete our determination that the claims advanced by Transco based in federal law are without merit.

V. TRANSCO'S CLAIMS UNDER STATE LAW

A. The Board's Authority To Promulgate A Ratable Take Rule

Turning to the state law claims, Transco first argues that the Oil and Gas Board was without authority to adopt or enforce a

rule requiring ratable taking such as Rule 48. The point is without merit.

The State Oil and Gas Board is a creature of the legislature and, of course, has no authority other than that vested in it by statute. *Masonite Corporation v. State Oil and Gas Board*, 240 So.2d 446, 449 (Miss. 1970). To ascertain what authority the Board has, we consult the Mississippi Oil and Gas Conservation Act of 1948, originally enacted as House Bill No. 80, Miss. Laws of 1948, Chapter 256, and now codified as amended as Miss. Code Ann. § 53-1-1, et seq., (Supp. 1983).

Looking to the words of that enactment we find in Section 53-1-17(c) Board authority to carry out the general policy directives of Section 53-1-1 which are, in part, that the co-equal and correlative rights of owners in a common source or pool of oil and gas shall be safeguarded to the end that each such owner in a common pool or source of supply of oil and gas may obtain his just and equitable share of production therefrom. *Barnwell, Inc. v. Sun Oil Company*, 249 Miss. 398, 406, 162 So.2d 635, 638 (1964).

An understanding of the legislative words emerges from thought about what co-equal and correlative rights such owners have under our law and just why and from what these rights need protection.

Our core concern, at the risk of repetition, is the geological phenomenon of drainage, described in *Shell Oil Company v. James*, 257 So.2d 448 (Miss. 1971) in this way.

> When the pool of oil has been penetrated by a recovery well, the oil and gas located in the pool move from a high pressure area to a low pressure area so that the oil and gas migrate from the property of one landowner to another. This exodus is called drainage. 257 So.2d at 494-495.

In this context we understand the correctness of the observations in one of the leading treatises on oil and gas law, *Summers on Oil and Gas*, Vol. IA, § 103.1 at 132:

> The mere opportunity of a landowner to take his share of the oil and gas in a common source of supply does not provide complete protection of his property rights in them. If others produce and market, he must also produce and market or lose much of his share through drainage and the exhaustion of reservoir energy. He cannot produce and market unless a market outlet is available. To provide market outlets for both oil and gas a few states have enacted common purchaser statutes requiring common carrier pipelines or other persons in business of purchasing oil or gas in a common source of supply to take ratably from all owners.

The geological realities of the world of oil and gas have sensitized the lawmakers of this state. *Phillips Petroleum Co., v. Millette*, 221 Miss. 1, 15-17, 72 So.2d 176, 179 (1954) recognizes that the prevention of loss through drainage is required by fundamental notions of equity and justice. Our law has long ago translated these notions of equity and justice into enforceable rights vested in owners of interests in oil and gas rich lands. *Shell Oil Company v. James*, 257 So.2d 488, 495 (Miss. 1971). It is of such rights that our Legislature speaks when it declares in Section 53-1-1 the public policy of the state that "the co-equal and correlative rights of owners in a common source or pool" be protected. Similarly the Legislature speaks of such rights when Section 53-1-17(c) authorizes the Board to carry out the general policy directives of Section 53-1-1.

Being as redundant as occasionally are judges, our legislators have in Section 53-1-17(c)(12) vested the Oil and Gas Board with the authority to prevent abuse of these correlative rights which may result from non-uniform, disproportionate or unratable withdrawals causing undue drainage between tracts of land or resulting in one or more owners in such pool producing more than his just and equitable share of the production from such pool.

Moreover, the Board has the authority under Section 53-1-17(c)(13) to "prevent, so far as practicable, reasonably

avoidable drainage from each developed unit which is not equalized by counter-drainage." *Shell Oil Company v. James*, 257 So.2d 488, 493 (Miss. 1971).

Beyond that, the Board has implied authority to do what may be reasonably necessary to carry out the specific mandates of the Legislature. *State Oil and Gas Board of Mississippi v. Brinkley*, 329 So.2d 512, 514-515 (Miss. 1976); *Mississippi Public Service Commission v. Chambers*, 235 Miss. 133, 142, 108 So.2d 550, 554 (1959).

Couple all of this with the provisions of Section 53-1-17(c) which empower the Oil and Gas Board to make "such reasonable rules, regulations and orders as may be necessary from time to time in the proper administration and enforcement" of the oil and gas conservation laws of this state, *State Oil & Gas Board v. Mississippi Mineral & Royalty Owners Association*, 258 So.2d 767, 768 (Miss. 1971), and we have more than ample statutory authority vested in the Board enabling the promulgation and enforcement of a rule requiring ratable taking such as Rule 48.

We have upheld the authority of the Board to promulgate a variety of rules with respect to which arguably there is less express statutory authorization than is the case here. *See, e.g., Barnwell, Inc. v. Sun Oil Co.*, 249 Miss. 398, 406-07, 162 So.2d 635, 638 (1964) (Board has power to allocate and apportion production); *Frost v. Gulf Oil Corp.*, 238 Miss. 775, 791-92, 119 So.2d 759, 764 (1960) (Board rules supplement statute); *Corley v. Mississippi State Oil & Gas Board*, 234 Miss. 199, 211-13, 105 So.2d 633, 638 (1958) (perpetuation of 40 acre units and creation of field-wide unit upheld because the units would protect the co-equal and corelative rights of the owners); *Hassie Hunt Trust v. Procter*, 215 Miss. 84, 97-98, 60 So.2d 551, 556 (1952) (Board could designate drilling units); *Green v. Superior Oil Co.*, 59 So.2d 100, 101 (Miss. 1952) (upholding Board's spacing rules providing 320 acre units).

Requiring one such as Transco to take what it does not want should not be done lightly. The right to purchase what one

wants (at a negotiated price) and to decline the purchase of what one does not want is normally secured, absent extraordinary circumstances. One the other hand, the general contours of the police power of the state have become well-established, and that power may qualify rights otherwise secured.

In *Superior Oil Company v. Foote*, 214 Miss. 857, 59 So.2d 85 (1954), this Court, speaking of the exercise of the police power as vested in the Board, had this to say:

> The police power of the state includes not only regulations to promote public health, good morals, and good order, but also the . . . [authority] to regulate and to promote development of industry and utilization of natural resources in order to add to the wealth and prosperity of the state. 214 Miss. at 875, 59 So.2d at 93.

A corollary desideratum equally susceptible of lawful achievement via the state's police power calls for a currently fair division of those natural resources. This the policy statement of Section 53-1-1 proclaims when it declares it in the public interest to safeguard, protect and enforce the co-equal and correlative rights of owners in a common source of supply. This our Court has embraced when, in *Superior Oil Co. v. Foote*, we recognized that in the lawful exercise of its police power

> the state may enact regulatory laws for and proscribe methods of extracting oil and gas for the . . . protection of the correlative rights of all owners in a common source of supply. 214 Miss. at 876, 59 So.2d at 93.

Accepting values from our past, our law continues to cherish freedom of contract and freedom to contract. U.S. Const. art. I, § 10, cl. 1; Miss. Const. art. III, § 16 (1890). Those freedoms, however, are not unqualified. This Court has repeatedly recognized that ordinary economic freedoms generally secured are

> qualified by a proper exercise of the police power of the state. . . . Hence it is said that all contract and property

> rights are subject to a reasonable exercise of the police power.

Superior Oil Co. v. Foote, 214 Miss. at 876, 59 So.2d at 93; *Mississippi Milk Commission v. Vance*, 240 Miss. at 857, 129 So.2d at 661.

The Supreme Court of the United States has likewise recognized that the prohibitions of the facially absolute Contract Clause

> must be accommodated to the inherent police power of the State "to safeguard the vital interests of its people".

Energy Reserves Group, Inc. v. Kansas Power and Light Company, ____ U.S. ____, 103 S.Ct. 697, 704, 74 L.Ed.2d 569, 580 (1983).

The Legislature of this state has lawfully empowered the State Oil and Gas Board to protect the co-equal and correlative rights of owners in a common pool of natural gas. The Board's ratable take rule is a proper exercise of the authority so vested in it.

Without further ado, we hold that the State Oil and Gas Board has the authority to promulgate a rule requiring ratable taking, such as Rule 48, and has the authority to enforce that rule according to its tenor. We affirm so much of the order of the State Oil and Gas Board as requires Transco, if it takes at all from a common source of supply, to take ratably; that is, Transco is required to offer in good faith to purchase from every one of the various producing interests in the common source of supply[13] the same percentage of those producers' gas as it

[13]This is as good a spot as any to note our concern that we may not know accurately how many wells are in the common pool or common source of supply, i.e., how many wells are subject to drainage if Transco continues to take 100 percent of the allowable from the two Florida Exploration wells. The Board finds as a fact that the six wells: (1) Getty-Rogers, (2) Getty-Sipp, (3) Getty-Buckley, (4) Tomlinson-Willoughby, (5) Florida-Carlisle and (6) Florida-Barnes are producing from a common pool. Getty offered convincing proof that there may be others, and we find nothing in the Board's finding of fact which rejects that proof. Should there be other producers or owners who are suffering drainage, they will have to make that fact known to the appropriate tribunal before they may be afforded any relief.

purchases from that producer the highest percentage of whose interest Transco takes.

This is consistent with the language of Rule 48. It is likewise consistent with the authority vested in the State Oil and Gas Board by the Legislature. It is finally consistent with geological realities and national and state public policy, insofar as we are able to discern them.

Fixing prices, however, is another matter.

F. The Board's Lack of Authority To Regulate Prices or Proscribe Price Discrimination

Order No. 409-82 does not in clear and unequivocal language prohibit Transco's price discrimination. The order does not specifically order Transco to pay all non-contract owners in the common pool the same $7.907 per mmbtu as Transco is paying Getty. The order merely provides that Transco is ordered

(a) to comply with Statewide Rule 48,

(b) if it takes natural gas from the Harper Sand Gas Pool, to "ratably take from the wells producing from the common pool,"

(c) "to ratably take and purchase gas without discrimination in favor of one owner, operator or producer against another in the said common source or pool", and

(d) if it elects to take from the pool, to "ratably take and purchase without discrimination in favor of the operators Getty and Tomlinson against Coastal, the Fairchilds, and Inexco".

It is tempting to speculate regarding the reason the Board stuck so close to the exact language of Rule 48 and, by way of contrast, eschewed use of any language expressly proscribing price discrimination and requiring that Transco pay one and all the $7.907 per mmbtu price. Such a proscriptive order would hardly wash when Transco is paying Tomlinson $6.511 per mmbtu, and Florida Exploration $8.4066, and Sabine $5.00; and so forth—all in the same common source of supply. More fundamentally, the Board's choice of wording in Order No.

409-82 telegraphs its own uneasiness about its authority to regulate prices or prohibit price discrimination.

Notwithstanding the arguable vagueness of the order, everybody has construed it to proscribe Transco from further discrimination in price paid producers in the common pool. For example, Coastal's brief before this Court states

> "At the trial, we *all* knew that the issue was price . . . The record is literally replete with statements by Transco's counsel and witnesses that the *only* issue was price."
>
> —(Brief of Coastal Exploration, Inc., served November 29, 1983, at 66)

Our review of the record and the course of proceedings before the Board, and subsequently the Circuit Court, together with our study of the briefs of the parties, convinces us that *price* is and from the outset has been a major issue in this controversy. It is in this context that we turn to Transco's next argument, to-wit: Assuming *arguendo* that the Oil and Gas Board has lawfully required ratable taking, the Board has no authority to regulate or proscribe differences in price. In large part, we agree.

Our approach is the same as before. The Board has only that authority which the legislature has constitutionally and lawfully vested in it. Our question becomes, has the Legislature vested the Board with authority to fix wellhead or first sale prices purchasers such as Transco must pay for the gas they take?

Before it may be sustained, the price regulation feature of Order No. 409-82 must find its undergirding authority in the enactments of the Legislature. *Masonite Corporation v. State Oil and Gas Board*, 240 So.2d 446, 449 (Miss. 1970). Order No. 409-82 may not be validated solely by reference to the language of Rule 48 for the obvious reason that the Board may not give one of its rules a construction beyond the scope of the enabling authority emanating from the Legislature.

Our point of inquiry is *not* whether the State of Mississippi acting through its duly constituted Legislature has the authority to engage in price regulation. This authority lies well within what is commonly referred to as the police power of the state. *Nebbia v. New York*, 291 U.S. 502, 54 S.Ct. 505, 78 L.Ed. 940 (1934); *Mississippi Milk Commission v. Vance*, 240 Miss. 814, 855, 129 So.2d 642, 660 (1961). We are concerned with the narrower question whether the Legislature has vested the Board with authority to make or enforce price regulation measures such as those found in Order No. 409-82. In search the answer we again consult the Mississippi Oil and Gas Conservation Act of 1948, as amended, and that source only.

Keep well in mind the general policy of this state and this nation: that prices for the sale of goods or services ought to be the product of an arms-length bargain in particular and of the market place in general. Price regulation measures remain the exception. Because they are the exception and because they do violence to the generally valid values and economic realities represented by such catch phrases as "freedom of contract" and "supply and demand", price regulation measures must be authorized in clear and unmistakeable language.

The authority to regulate prices is a drastic departure from the norm. It may never be left to implication. If it has not been expressed, it does not exist.

This state today regulates the price paid by the consumer for electricity, natural gas and telephone service. Insurance premiums are also the subject of state regulation. In each of these instances the authority to regulate is delegated to the administrative agency in clear and unmistakeable language. A familiar example of this from the not too distant past is the Mississippi Milk Commission Act, Senate Bill No. 1757, chapter 155, Laws of 1960. *Mississippi Milk Commission v. Vance*, 240 Miss. 814, 860, 129 So.2d 642, 662-663 (1961).

Against this backdrop we regard the stark contrast presented by the Mississippi Oil and Gas Conservation Act of 1948. First, we find no mention of a need to regulate wellhead sales

prices in the declaration of policy in Section 53-1-1. Beyond that, there is no such authority provided in Section 53-1-17, the statute enumerating the lawful powers of the Board. Not even the newly enacted Section 53-1-17(f)[15] provides any such authorization. Indeed, the word "price" is not used, nor any of its synonyms.

The only mention of the term price in any legislative language empowering the Board appears in Section 53-1-17(c)(17), to wit:

> To make such determinations of oil and/or natural gas maximum lawful ceiling prices as allowed by federal or state law.

The price regulation feature of Order No. 409-82 obviously is not a determination of maximum lawful ceiling prices within Section 53-1-17(c)(17). As indicated at the outset, we are concerned here with deregulated gas.

Turning to the history of the Conservation Act and the Board's experience with it, we again find no hint that the Board has heretofore considered that it has price fixing authority. In part this might be explained by the pre-1978 federal preemption of the pricing of wellhead first sales. *Northern Natural Gas Co. v. State Corporation Commission of Kansas*, 372 U.S. 84, 91-92, 83 S.Ct. 640, 650-51, 9 L.Ed.2d 601, 607 (1963); *Phillips Petroleum Company v. Wisconsin*, 347 U.S. 672, 682-84, 74 S.Ct. 794, 799-800, 98 L.Ed. 1035, 1047-48 (1954). Whatever the reason—because Natural Gas Act of 1938 had preemptive effect, because such price regulation is not needed to give owners adequate and reasonable protections against the perceived evils of drainage, or because collectively the Legislature never thought of the matter, the outcome determinative fact is that the Legislature simply has not vested the Board with authority to fix wellhead first sale prices of natural gas. This is so whether the price fixing be done directly or under the ruse of prohibiting discrimination.

---

[15]See Chapter 506, Miss. Laws of 1983, originally House Bill No. 919.

Rule 48 has been promulgated for over thirty years. We are aware of no evidence prior to Order No. 409-82 that the Board has heretofore considered Rule 48 to proscribe price discrimination. The primary prior Board proceeding discussed in the briefs is *In Re Petition of Cenard Oil and Gas Co.*, Docket No. 60-64-92, Order No. 81-64, dated April 16, 1964. In that case the Board correctly found Southern Natural Gas Co.'s refusal to purchase gas from Cenard's two wells completed into a common reservoir at the same rate as it purchased from another to be a violation of Rule 48. The Board's order directing Southern natural to take ratably and otherwise comply with Rule 48 makes no mention of price.

We are loathe to tell an administrative agency how to construe its own rule. In this case the Board has determined to enforce an order in part at least unauthorized by the enabling legislation. In this context it becomes our responsibility to advise the Board that the only lawful interpretation of the rule is that Transco, if it desires to take at all from a common source of supply, must take ratably. With respect to price, that is a matter of private negotiation between the parties. Any owner who wishes to enter into a contract with respect to the sale of his interest is free to do so. If for whatever reason, the owner wishes to "play the market", he is entitled both to the benefits of a high demand market and the burdens of a market glut such as we have now. Any other interpretation of the rule is arbitrary, capricious and unlawful.

All of this is particularly true when it is remembered that the statute has not authorized the Board to engage in price regulation and when it is likewise remembered that the dominant legislative concern was protecting producers and owners from the geological phenomenon of drainage, a far different matter from the economic phenomenon of price discrimination.

Mississippi is not the only natural gas producing state which has determined that requiring ratable taking without any regulation of or prohibition on discrimination in price is a rational state policy. The Louisiana Supreme Court has interpreted

language similar to Rule 48 in its common purchaser statute as applying only to quantity and not price. In *State v. Arkansas Louisiana Gas Co.*, 227 La. 179, 78 So.2d 825 (La. 1955), Arkla was brought to trial for offering only five cents per one thousand cubic feet of gas (mcf)[14] to some when it was paying others 11¢/mcf for gas produced from the same pool. As in this case, the issue was price only. Louisiana's attorneys contended that the term "purchase . . . without discrimination" in the statute must include price differences or else the statute would be meaningless. The court responded:

> . . . We cannot find or discern any prohibition against 'price' discrimination, and we cannot read such a prohibition into the statute. . . .
>
> It is manifest that *the statute was obviously drawn to prohibit discrimination solely in the matter of quantity,* to prevent unfair, discriminatory and inequitable abuses in the distribution of natural gas, not as to prices to be paid, but solely to give security to producers in that they would all stand on an equal footing insofar as access to a market through pipeline facilities would be made available. The statute sought to alleviate and prevent the abuses whereby some producers were favored as against others, some afforded markets, others ignored, and, by the process of prorating among producers, assured them that no one would sell more than the other in a . . . [common source of supply]. 227 La. at 188-89, 78 So.2d at 828 [Emphasis added]

The construction Louisiana's Supreme Court has placed on its ratable take statute, of course, is not controlling here. In determining that the Mississippi Legislature has *not* decided that a regime of price regulation or a prohibition on discrimination in wellhead sales prices are necessary parts of the state's important policy of protecting the "the co-equal and correlative

---

[14]The two predominant units of natural gas measurement, one thousand cubic feet (mcf) and one million British thermal units (mmbtu), contain approximately equivalent amounts of energy.

rights of owners in a common source" of supply, although it may well have the authority to so provide, we take comfort from the fact our present law and policy are consistent with what at least one sister natural gas producing state has done.

There is a final reason why we have refused to imply Board authority to regulate wellhead sales prices. For the moment we have difficulty understanding how the sort of price regulation attempted in Order No. 409-82 serves legitimate public interest as distinguished from private self-interests.

Price differentials emanating from arms-length contract negotiations are surely not contrary to the public interest. Many legitimate economic factors may produce such differentials, not the least of which would be the length of the contract, whether the price was fixed or subject to variation, supply and demand and other prevailing and reasonably foreseeable market conditions. The record before this Court reflects 35 contracts ranging from $5.00 to $9.054 per mmbtu. The record also suggests that these differentials are the proximate result of different dates of contracting and rapidly changing market conditions, both of which will ordinarily be considered rational bases for differences in price interference with which is beyond the Board's authority.

Transco, required to take ratably by Rule 48, is free to offer owners having no contract a price reasonable in the context of the then existing market conditions. If the owner thinks the price is too low and wishes to risk drainage, he does not have to sell. But he has no legal redress simply because he failed to lock in a price via contract at a time when the market was more favorable.

The owners of interests in a common source of supply are perfectly free to contract for the sale of their share of production on whatever terms they can negotiate. If owners such as Coastal desire to operate without a contract, for whatever reason, this is their privilege. If there should be an overall market shortage and increased demand amongst consumers, parties such as Coastal certainly stand to benefit. On the other

hand, where a market glut and decreased demand occur, Coastal and others no doubt suffer.

Why in an era of deregulation freedom of contract is perceived to be bad as a matter of policy escapes us. The national policy, to be sure not a preemptive one, is that the price of natural gas at the wellhead shall be regulated by market and geological forces, not judicial or administrative fiat. Regulation as heretofore practiced has failed. Whatever bugs may remain in the "deregulation system" and whatever fine tuning may be needed in our laws, the efficacy of regulation remains questionable and its substantial costs demonstrable. Pierce, *Reconsidering The Roles of Regulation And Competition In The Natural Gas Industry*, 97 Harv.L.Rev. 345, 371-372 (1983). The ultimate regulator of the price of such gas, at least for the moment, is what the consumer is willing to pay, with FERC interjecting itself into the picture only where wellhead prices have been set by fraud or collusion.

A caveat need be added: we do not hold that a pipeline purchaser may offer any terms, take-it-or-leave-it, and meet its Rule 48 obligations. Offering a working interest owner a choice between a substantially below market price or otherwise wholly unreasonable terms, on the one hand, and drainage, on the other, is simply not a ratable taking and is a violation of Rule 48. To comply with its Rule 48 obligations the pipeline must offer in good faith reasonable terms, including a reasonable price, determined by reference to prevailing market conditions and other appropriate economic considerations.

Of course, nothing in Rule 48 requires that Transco take any gas from a given source of supply. If it takes at all, however, it must take, or in good faith offer to take ratably.

So much of Order No. 409-82 as may be construed to require that Transco, in the course of performing its lawful duty to take ratably, pay Coastal and others not under contract $7.907 per mmbtu is reversed.

G. Miscellaneous Other Alleged Errors in Board Rulings

Transco presents to the Court further assignments of error, denominated in its brief, Reversible Errors In The Board's Rulings.

First, Transco argues that the Board was arbitrary and capricious in finding that Transco was discriminating against Coastal and owners of relatively small working interests in violation of Rule 48. We made clear above in Section II(C) entitled "Non-Facts" that neither the "size" of the parties nor of their interests was a fact of legal significance here. Nothing said in the intervening pages should cause us to lose sight of that elementary proposition.

In any event, our substantive holding that Transco has lawfully been ordered to take ratably (if it takes at all) and to take ratably the gas of each owner in the common pool without regard to size of owner or interest coupled with our further holding that the Board has no authority to engage in price regulation should effectively dispose of this issue.

Next, Transco argues that there is no substantial evidence to support the Board finding that ratable production occurred prior to July 1, 1982, and that Transco's "cutback" has or will cause non-ratable withdrawals or drainage. The point is specious. There may well be reasons not attributable to Transco why there may not have been ratable production prior to July 1, 1982. This would do nothing to ameliorate the undeniably discriminating effect of Transco's refusal after July 1, 1982, to take ratably, and more specifically, to take the production of the non-contract interest owners. The assignment of error is rejected.

Finally, Transco argues that the Board improperly refused to receive and consider relevant evidence proffered by Transco and other parties to the substantial prejudice of Transco. We find no merit in this contention.

The hearing of this matter was had in accordance with the official Rules Of Order And Procedure For Hearings Before The Board, Order No. 201-51, Rule 13(c) of which provides

> (c) The materiality, relevancy and competency of any testimony shall be subject to challenge by any party to the hearing or by any member of the Board. When so interposed, such objections shall be acted upon by the Chairman or by the Acting Chairman, his ruling thereon being subject to change by a majority vote of the Board members then sitting.

There is no necessity for enumeration of the points recited by Transco here. Suffice it to say that Transco has not suffered cognizable prejudice from any of the Board's evidentiary rulings, in that none of the excluded evidence would have proved or tended to prove that after July 1, 1982, Transco was taking ratably. Absent prejudice, any error in exclusion is harmless and cannot be grounds for reversal. *Planters Bank v. Garrott*, 239 Miss. 248, 270, 122 So.2d 256, 264 (1960). All other assignments of error not heretofore expressly passed upon are denied and rejected.

IV. CONCLUSION

For the reasons set forth above, so much of Order 409-82, and the Circuit Court's affirmance thereof, as requires that Transco, if it takes or purchases natural gas from the Harper Sand Gas Pool in Greens Creek and East Morgantown Fields, take ratably from the common pool and without discrimination in quantity or percentage thereof in favor of one owner, operator or producer against another in such common pool is affirmed.

So much of Order 409-82, and the Circuit Court's affirmance thereof, as may be construed to require that Transco, if it takes or purchases from said pool, purchase without discrimination in price is reversed and rendered.

This matter is remanded to the Circuit Court with instructions that the matter be further remanded to the State Oil and

Gas Board for such further proceedings as may be appropriate not inconsistent with this opinion.

Taxable costs in this Court, before the Circuit Court, and before the Board shall be and they hereby are taxed one-half against Transco as Appellant and one-half against Appellees, jointly and severally, for all of which let execution issue.

AFFIRMED IN PART; REVERSED IN PART.
WALKER, P.J., ROY NOBLE LEE, P.J., DAN M. LEE, PRATHER, AND SULLIVAN, JJ., CONCUR. PATTERSON, C.J., BOWLING, HAWKINS, JJ., NOT PARTICIPATING.

APPENDIX B

IN THE CIRCUIT COURT OF THE FIRST JUDICIAL DISTRICT OF HINDS COUNTY, MISSISSIPPI

No. 29,393

TRANSCONTINENTAL GAS PIPELINE CORPORATION
Appellant

VS.

THE STATE OIL & GAS BOARD OF MISSISSIPPI, COASTAL EXPLORATION, INC., WILEY FAIRCHILD, RODNEY FAIRCHILD, W. R. FAIRCHILD CONSTRUCTION COMPANY, AND INEXCO OIL COMPANY
Appellees

COASTAL EXPLORATION, INC.
Appellee
and Cross-Appellant

VS.

TRANSCONTINENTAL GAS PIPELINE CORPORATION, GETTY OIL COMPANY, TOMLINSON INTERESTS, INC., AND THE STATE OIL & GAS BOARD OF MISSISSIPPI

Appeal From The State Oil And Gas Board of Mississippi

MEMORANDUM OPINION AND ORDER OF THE COURT

This case is before the Court as an appeal by Transcontinental Gas Pipeline Corporation ("Transco") from Order No. 409-82 entered by the State Oil and Gas Board of Mississippi ("Board") in a contested matter in which Transco was the respondent. The Board found that Transco was violating the Board's Statewide Rule 48 by engaging in discriminatory purchasing practices among producers in a gas pool, and was violating Mississippi Code Annotated Section 53-3-3 and 53-3-1 by committing and causing "waste" to take place by Transco's unratable takes of gas from wells producing from the gas pool so as to cause unit-to-unit drainage. Among other things, the Board ordered Transco to purchase without discriminating against certain producers and to take gas ratably from the wells producing from the gas pool, if and when Transco took gas from the pool.

Transco's assignments of error fall into three (3) general categories:

(1) Claimed procedural and evidentiary errors by the Board (assignments 1 through 3);

(2) The claimed lack of jurisdiction or authority under state law to adopt or enforce Statewide Rule 48 (assignments 4 and 5); and

(3) Federal claim challenges which, in substance, allege that Statewide Rule 48 and Order No. 409-82 attempt to regulate an area which has been preempted by federal law, and are unconstitutional. (assignments 6 through 9)

As to Transco's federal claim challenges, Transco has assigned these alleged errors but has also attempted to "reserve" these issues for litigation in federal court, relying on *England v. Louisiana State Board of Medical Examiners*, 375 U.S. 411 (1964), as authority. Coastal Exploration, Inc. ("Coastal") has

filed a Motion to Strike Attempted Reservation of Federal Claims, with supporting exhibits, asking the Court to strike the attempted reservation and rule on all of the assigned errors.

The Court affirms Order No. 409-82 in its entirety and, in so doing, sustains Coastal's Motion to Strike Attempted Reservation of Federal Claims, disregards the attempted reservation of the assigned errors, and addresses all of the assigned errors. In doing so, the Court is mindful of and takes judicial notice of the fact that the state law and federal law issues before this Court are of extremely important interest to all facets of the oil and gas industry of this state, as well as the other oil and gas producing states of this country, concern vital state interests, and need and deserve an early and complete resolution in the forum in which they arose.

There can be no meaningful discussion of these important issues without a review of the facts which the Court finds to have been established by the evidence before the Board. Thus, it is appropriate first to review just how this controversy developed. How did the parties get here from there?

FACTS

The Harper Sand Gas Pool underlies portions of both the Greens Creek Field and the East Morgantown Field of Marion County, Mississippi. These two field are contiguous. If only one well were completed into this pool and produced from this pool, it would drain the entire pool.

Six gas wells are completed into and producing from the Harper Sand Gas Pool: The Getty-Rogers 28-11 Well, the Getty-Sipp 20-9 Well, the Tomlinson-Willoughby 3-5 Well, the Getty-Buckley 33-6 Well, The Florida Exploration-Carlisle 4-2 Well and the Florida Exploration-Barnes 29-1 Well. The Harper Sand Gas Pool produced by these wells lies below 15,000 feet and all of the wells producing from this pool have

been classified as "deep, high-cost wells" under Section 107(c) of the Natural Gas Policy Act of 1978 ("NGPA").

Coastal owns small undivided working interests (generally less than 1%) in the units for four of the six wells which produce from this pool, owning in the Rogers, Sipp, Willoughby and Barnes wells. Coastal participated in the drilling of each of these wells, voluntarily paid its share of drilling and completion costs, and has timely and regularly paid its share of operating costs for each of these wells. Because of its ownership in these wells, Coastal owns and has the right to its fair and equitable share of gas produced from the pool by the wells.

When the wells in question first began producing gas in April 1981, with production from the Sipp Well, the gas was sold to Transco. Getty, as the operator and owner of a substantial working interest in the Getty-operated units, had previously entered into a gas purchase contract with Transco. Transco had not negotiated or offered gas purchase contracts to each of the many other working interest owners in the Getty-operated wells, so that many owners of small undivided interests, like Coastal, had no gas purchase contract when first production began. However, in accordance with the industry practice, Getty produced all owners' gas and delivered the gas to Transco which in turn purchased and paid for all of the gas at the same price and on the same terms and conditions as Transco purchased and paid for Getty's share of gas. This practice was consistent with Statewide Rule 48, which forbids purchasers from discriminating in favor of one owner, operator or producer against another in the same common source of supply.[1]

As the other wells completed into the pool began producing, the same procedure was followed, the effect being that Transco

---

[1]Statewide Rule 48 of the State Oil and Gas Board provides as follows:

"Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, or producers shall purchase without discrimination in favor of one owner, operator or producer against another in the same common source of supply."

took gas ratably as between the wells producing from the pool and purchased gas without discrimination in favor of the operator as against Coastal and the other owners of small undivided interests.

This situation continued from April 1981 until on or about July 1, 1982, when Transco ceased purchasing the gas of owners (producers) who did not have a contract with Transco. In May 1982, Transco notified Getty and Tomlinson that effective June 1, 1982 (later changed to July 1, 1982), Transco would no longer take or purchase the gas of those producers who had not entered into a gas purchase contract with Transco, so-called "non-contract producers." However, because of certain provisions of the Florida-Transco gas contract, Transco would continue to purchase non-contract producers' gas produced from the Florida-operated wells and pay those producers the same price Transco paid Florida.

After receiving this notice from Transco, Getty and Tomlinson notified Coastal that they, as operators, would not produce Coastal's share of gas from the Rogers, Sipp and Willoughby Wells unless Coastal obtained its own purchaser and its own gas purchase contract. A similar type notice was sent to other non-contract producers.

On or about July 1, 1982, production of the Rogers, Sipp and Willoughby wells was reduced or cut-back to account for Transco's refusal to buy non-contract producers' gas from those wells. The result was that Transco began taking gas unratably from the wells producing from the pool, taking a lesser percentage of deliverability from the Getty and Tomlinson Wells than from the Florida Wells.

Following the notice from Getty and Tomlinson, Coastal attempted to obtain another gas purchaser to whom it could sell its gas, but was unsuccessful. Coastal then requested Transco to purchase Coastal's share of gas producible from the Rogers, Sipp and Willoughby Wells on the same terms and conditions as Transco purchased gas from the operators of those wells or to give Coastal a gas purchase contract like

Transco had given the operators. However, at that point in time Transco refused to purchase Coastal's gas at all.

On July 29, 1982, Coastal filed a petition with the State Oil & Gas Board to require Transco to comply with Statewide Rule 48 by ratably taking gas from the wells producing from the common pool and purchasing without discrimination in favor of the operators, Getty and Tomlinson, against Coastal. After Coastal filed its petition, Transco then offered to buy Coastal's gas at $5.00 per MMBTU under a contract which would contain a "market out" clause to allow Transco to lower the contract price whenever Transco felt that the price was "uneconomic." Transco's gas purchase contracts with Florida, Getty and Tomlinson contained no such clause, and Transco planned to continue paying Getty and Tomlinson $7.90 per MMBTU for their share of gas produced from the same wells. Coastal did not accept this proposal, claiming that it violated Statewide Rule 48.

At the hearing before the Board in September 1982, Transco claimed that Statewide Rule 48 was invalid as a matter of state law and that the Board had no authority to require Transco to ratably take or purchase without discrimination because federal law had allegedly preempted the area, and because Rule 48 allegedly was unconstitutional for a variety of reasons.

A three day trial was held before the Board during which Transco defended the action by the presentation of witnesses, exhibits and legal arguments, raising as defenses the same claims which it now asserting before this Court.

The Board granted Coastal's petition and on October 13, 1982, entered its Order No. 409-82 dated September 16, 1982. On October 15, 1982, Transco perfected its appeal to this Court.

THE ASSIGNMENTS OF ERROR

The Court chooses to address the Assignments of Error in the reverse order in which they are raised because the claims of federal preemption and unconstitutionality of the Board's ac-

tion are the threshold issues. If the Board's order has invaded an area preempted by the federal government or is unconstitutional, then there is no need to reach and decide the issues of state authority and substantial evidence. However, in order to reach the claims of federal preemption and unconstitutionality, the Court must first consider the claimed *England* reservation.

THE CLAIMED ENGLAND RESERVATION

Before considering the propriety of the claimed *England* reservation, it is appropriate to review the facts relevant to the claimed reservation.

In response to Coastal's petition filed with the Board, Transco raised several federal claim defenses and objections to the subject matter jurisdiction of the Board, Transco's contentions being that (1) the owner of the Board to issue such an order had been preempted by the Federal Energy Regulatory Commission's ("FERC") jurisdiction under the Natural Gas Act ("NGA") and the NGPA, (2) that Statewide Rule 48 violated the Commerce Clause and (3) that the requested relief would be discriminatory against Transco (presumably an equal protection argument), would constitute an unlawful taking of private property without compensation (presumably a due process argument) and would impair Transco's right to contract (presumably a Contract Clause argument). Before the Board hearing was held, the Board specifically requested and received briefs from the parties, including Transco, on the federal preemption claims. However, the Board rejected all of Transco's federal claim defenses, concluding that the Board had subject jurisdiction of the controversy.

On October 13, 1982, the day the Board actually entered Order No. 409-82, Transco filed suit in the United States District Court for the Southern District of Mississippi naming the State Oil and Gas Board as a Defendant and asserting as its federal claims the very same federal claim defenses which it had raised in the state proceedings before the Board. Coastal,

Getty and Tomlinson subsequently intervened in that federal suit on the side of the Board.

Assignments of Error 6 through 9 are the same federal claim defenses which Transco raised and litigated in the proceedings before the Board. However, Transco claims that *England* allows it to assign these items as errors before this Court, yet reserve them for determination in the federal suit it filed after the conclusion of the state trial proceedings.

Transco's reliance on *England* is misplaced. This is because *England*, by its own terms as well as by the cases which have applied it, applies only when the following conditions are met.

1. First, suit is filed in federal district court in the first instance.

2. Second, the federal district court then abstains from the exercise of its jurisdiction, pursuant to *Railroad Commission of Texas v. Pullman Company*, 312 U.S. 496, 61 S.Ct. 643 (1941) ("Pullman Abstention"), pending a determination of a question of unsettled state law.

3. Third, the federal plaintiff is then relegated to state court in order to get a determination from the state court regarding the question of unsettled state law.

4. Fourth, the federal plaintiff, who has been ordered into state court against its will, whether as a plaintiff or defendant in the state court action, may then "reserve" its federal claims from being decided in the state court suit so that, at the conclusion of the state court suit, the federal plaintiff may return to federal court for a determination of its federal claims originally asserted in federal court.

These conditions for an effective *England* reservation have not been met in the case at hand. Transco initiated its federal court suit on October 13, 1982, on the same day as the Board entered its order concluding those proceedings, almost three (3) months after Coastal commenced the proceedings before

the Board which are the subject of this appeal. With regard to the second condition set forth above, the Court notes that on February 18, 1983 the Federal District Court for the Southern District of Mississippi entered its "Memorandum Opinion" declining to abstain from the exercise of its jurisdiction on the grounds that it was inappropriate because, *inter alia*, "Statewide Rule 48 appears to be settled." Under *England*, it is only in the event that Pullman Abstention is ordered by a district court that a federal plaintiff, who is then sent to state court against his will, may "reserve" his federal claims for later determination in federal court after he returns there from state court. In this case, however, the federal district court has retained its jurisdiction and has not ordered Pullman Abstention.

An examination of the cases which have applied *England* reveals that it does not stand for the proposition that a litigant (like Transco) has the right to raise federal claim defenses as a defendant in a state proceeding and then, after losing at trial, assign them as grounds for reversal of the state action but "reserve" those alleged errors for "determination" in federal court without pursuing them on appeal through the state courts. Among other defects in that procedure is the fact that it represents an attempt to appeal from a state administrative agency or court to federal court. An *England* reservation is available only where the controversy initially arises by way of a federal court suit which is filed before state proceedings are initiated, followed by the federal court then abstaining under *Pullman* and relegating the federal plaintiff to state court to resolve alleged "unsettled" questions of state law. In particular, see, e.g., *Gresham Park Community Organization v. Howell*, 6S2 F.2d 1227, 1243 (5th Cir. 1981), *Cornwell v. Ferguson*, 546 F.2d 1022 (5th Cir. 1977), and *Ball v. Board of Trustees*, 584 F.2d 684 (5th Cir. 1978), which stand for the proposition that an *England* reservation is not available where the controversy first began in state court or before a state administrative agency; and *Fair Assessment v. McNeary*, 454 U.S. 100 (1981), *Roy v. Jones*, 484 F.2d 96 (3rd Cir. 1973), *Howell v. State Bar of*

Texas, 674 F.2d 1027 (5th Cir. 1982) and *Allen v. McCurry*, 449 U.S. 90 (1980), holding that Pullman Abstention must be ordered by the federal district court in order for an *England* reservation to be available in state court; and *Harman v. Forssenius*, 380 U.S. 528 (1965), and *Alt v. City of Biloxi*, 397 So.2d 897 (Miss. 1981), which stand for the proposition that an *England* reservation is not available unless Pullman Abstention is ordered because of an unsettled question of state law.

In the words of the Mississippi Supreme Court in *Alt v. City of Biloxi*, *supra*, which case considered an *England* reservation question, Transco, as the respondent or defendant to the Board proceedings, "is not a party who had 'a choice' between state and federal courts and who chose the latter."

Accordingly, the Court sustains the Motion to Strike Attempted Reservation of Federal Claims, disregards the attempted reservation, and considers the federal claim challenges which have been assigned by Transco as errors.

I. FEDERAL CLAIM CHALLENGES

1. The Federal Preemption Claim

In its Assignments of Error and in its defenses before the Board, Transco has claimed that the Board's authority to regulate or affect an interstate gas pipeline's purchase of natural gas has been preempted by the Natural Gas Act of 1938 (NGA) and the Natural Gas Policy Act of 1978 (NGPA) and is within the exclusive jurisdiction of the Federal Energy Regulatory Commission (FERC), the successor to the Federal Power Commission (FPC). Transco places principal reliance upon *Northern Natural Gas Company v. Corporation Commission of Kansas*, 372 U.S. 84 (1963), wherein the Supreme Court held invalid a ratable take/minimum price order entered against an interstate pipeline because, at that point in time, the order invaded the FPC's regulatory jurisdiction under Section 1(b) of the NGA. However, Coastal et al contend that the effect of the passage of the NGPA in 1978, and specifically NGPA Section

601(a), has been to exempt the "first sale" of the type of gas produced from the Harper Sand Gas Pool, from the NGA and FERC's jurisdiction under that Act. If Coastal is correct in its contention,then *Northern Natural*, and the NGA jurisdiction concerns which prompted that decision, is not applicable here, and the Board's order can be upheld as a matter of federal and constitutional law under *Cities Service Gas Company v. Peerless Oil & Gas Company*, 340 U.S. 179 (1950), in which the Supreme Court upheld a ratable take order similar to Order No. 409-82. The issues thus drawn, a brief review of both the NGA and NGPA are in order, particularly the reasons prompting passage of the NGPA in 1978.

The Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978

Section 1(b) of the NGA, 15 U.S.C.A. Section 717(b), is the jurisdictional section of the Act and clearly defines the scope of the NGA, to-wit:

> The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

In 1947, the United States Supreme Court, in *Panhandle Eastern Pipeline Company v. Public Service Commission of Indiana*, 332 U.S. 507, 92 L.Ed. 128, 68 S.Ct. 190 (1947), examined Section 1(b) of the NGA and defined the powers granted to the FPC:

> This section [Section 1(b)] determines the Act's coverage and does so in the light of the situation existing at the time. Three things and three only Congress drew within

> its regulatory power, delegated by the act to its agent, the Federal Power Commission. These were: (1) the transportation of natural gas in interstate commerce; (2) its sale in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or sale. (332 U.S. at 516).

This statement was quoted with approval in *Federal Power Commission v. Louisiana Power & Light Company*, 406 U.S. 621, 32 L.Ed. 2d 369, 92 S.Ct. 1827 (1972). Based upon the language of the NGA itself, as well as the above-mentioned cases, it is clear that FERC's jurisdiction, although wide ranging, is less than plenary. FERC's grant of jurisdiction flows from Section 1(b) of the NGA. It can regulate the activities of producers and pipelines only insofar as it is permitted to do so by the Act.

Prior to enactment of the NGPA in 1978, two NGA regulatory features actively discouraged the introduction of new supplies of natural gas into interstate commerce: (1) the literal regulatory maze which a producer and a pipeline had to go through and comply with before a pipeline could purchase gas for the interstate market, and (2) extremely low NGA-mandated and FERC determined "just and reasonable" ceiling prices which a pipeline could pay a producer for gas.[2]

The extent of FERC's pre-NGPA total control over all aspects of the producer/pipeline sale and purchase of gas can be appreciated by an examination of FERC's pre-NGPA/NGA-power to grant or deny a certificate of public convenience and necessity. Under the NGA, gas could not even lawfully enter the interstate market unless FERC first issued a certificate of public convenience and necessity. FERC would not issue the required certificate unless the producer-pipeline contract contained certain price limitation clauses and excluded other types

---

[2]*See* e.g., analysis of the NGA set forth in *Tenneco, Inc. v. Sutton*, 530 F. Supp. 411, at 417–18 (M.D. La. 1981).

of clauses.[3] Thus, through its power to grant or deny the required certificate of public convenience and necessity, FERC was able to directly dictate the contract terms and price which a pipeline could pay and a producer could receive.

The reason the ratable take order in *Northern Natural* invaded the FPC's jurisdiction under Section 1(b) of the NGA was because the order, at *that* point in time, directly conflicted with two of FPC's then fundamental regulatory powers: FPC's NGA power to admit or deny the entry of gas into interstate commerce, and FPC's NGA power of approval (or disapproval) of the price paid for the gas by the pipeline. The Kansas ratable take order at issue in *Northern Natural* clearly interferred with both of those two powers because (1) the order forced gas into interstate commerce without a *then* required certificate of public convenience and necessity from FPC, and (2) the order required the payment of a set price without the *then* require prior adjudication by FPC that the price was "just and reasonable." As hereinafter discussed, neither of those two regulatory powers survived enactment of the NGPA as to "undedicated gas"[4] or Section 107 gas[5] or "dedicated gas" which is also qualified as NGPA Section 102 or 103 gas.

It was because of these discouraging features of the NGA and FERC's regulatory powers under the NGA that producers began selling their gas in the *intrastate market* (they did not have to deal with the NGA or FERC and they could get a much higher unregulated price), and concomitantly, pipelines like Transco were unable to purchase gas for the *interstate market*. By the late 1970s this "cause and effect" finally culminated in severe gas shortages in the interstate market, while at the same time there existed an abundance of higher priced gas in

---

[3]*See*, e.g., 18 C.F.R. Sections 154.93 and 154.103. *See also* the "Curtis/Jackson Letter" of September 8, 1978 which appears as a part of the legislative history of the NGPA.

[4]"Undedicated Gas" is gas which was not committed or dedicated to interstate commerce as of November 8, 1978. *See* NGPA Section 601(a)(1)(A).

[5]*See*, NGPA Section 601(a)(1)(A)(B).

the intrastate market. That "national problem" of gas shortages in the interstate market was *the* fundamental reason why Congress passed the NGPA.[6]

In passing the NGPA, Congress had two central goals: To provide price incentives to producers to drill more wells, find new gas and put that new gas into the interstate market, and to free the producers and pipelines from those regulatory aspects of the NGA and FERC's jurisdictionwhich were discouraging producers from selling gas to the pipelines and crippling pipelines' ability to purchase new gas.[7]

Those congressional goals were reached by Congress (1) eliminating FERC's NGA-jurisdiction and power to require a producer and a pipeline to obtain FERC approval of the entry of new gas into the interstate market and FERC approval of the price to be paid by the pipeline for that gas, and (2) enacting immediate price deregulation for some new gas (like "deep, high-cost gas" under Section 107), and gradual price deregulation for other new gas (like gas under Sections 102 and 103). Sections 121 and 601 of the NGPA accomplished these goals.

First, Section 121 was included to provide producers with the price incentives they needed to find new gas and sell that gas in the interstate market. Thus, Section 121 immediately eliminated price controls for Section 107 "deep, high-cost gas" and set a 1985 date for price deregulation of other new gas, such as gas qualifying for pricing under Sections 102 and 103. Section 121 thus furnished the price incentives which Congress intended.

---

[6]*See*, e.g., *Tennecco, Inc. v. Sutton, supra*, 530 F.Supp. at 418, n. 24 and 25 at 420–21; *Mid-Louisiana Gas Co. v. FERC*, 664 F.2d 530, 533 (5th Cir. 1982); *Pennzoil Co. v. FERC*, 645 F.2d 360, 380 (5th Cir. 1981), at 367, n. 13.

[7]*See*, e.g., authorities cited in note 6, *infra*. *See also Pennzoil Co. v. FERC, supra*, 645 F.2d at 378 ("The NGPA is a fundamental change in regulatory outlook.") In *Pennzoil*, the court concluded that the effect of § 601(a)(1)(A) was to deny FERC the authority to regulate or interpret gas purchase contracts covering "undedicated" gas. *Id* at 380. *See also Mid-Louisiana Gas Co. v. FERC, supra* 664 F.2d at 535.

Second, Section 601 was included to provide producers and pipelines with freedom from regulatory interference by FERC with the pipelines' purchase and the producers' sale of new gas; to enable the pipelines to freely compete with unregulated contractual terms to buy new gas by allowing the pipelines to pay the producers the higher incentive prices for new gas (without *ever* having to get FERC approval of the prices paid or the other terms of the contract); and to exempt the pipelines and producers alike from the then existing constraints of the NGA and FERC's regulatory jurisdiction under the NGA, constraints which had combined with the low FERC-set "just and reasonable" prices (based on cost of service) to produce the severe gas shortages of the late 1970s brought on by the producers' reluctance (and sometimes refusal) to sell their gas in interstate commerce, and the pipeline's inability to buy new gas from the producers. Section 601 thus furnished the pipelines and the producers the degree of freedom from regulatory interference from FERC which Congress intended.[8]

Analysis of Section 601

Under the Section 601 statutory scheme, Section 601(a)(1) removes FERC's NGA-jurisdiction to directly or indirectly control or regulate a pipeline's purchase of Section 107 gas and the price paid by the pipeline for that gas. In place of that "lost" jurisdiction over the pipeline's purchases of that gas, Section 601(c) gives FERC the jurisdiction and power to deny a

---

[8]*See*, e.g., *Tenneco, Inc. v. Sutton*, *supra*, 530 F.Supp. at 419: "These provisions [Section 601] remove the Commission's authority to establish just and reasonable prices under the NGA for producer sales into the interstate market and to indirectly regulate these sales through control of the interstate pipeline purchaser's pass-through of purchase gas costs."

See also the "Curtis/Jackson Letter", *supra*, on Section 601: "This section [601] executes the legislature intent to remove from Natural Gas Act utility type regulation natural gas not heretofore dedicated or committed to interstate commerce (§ 601(a)(1)(A), and to remove from Natural Gas Act-type regulation heretofore jurisdictional sales of high cost gas, gas from new OCS leases, new well qualifying for the new natural gas price under section 102, and [103 gas] (§ 601(a)(1)(B))." FPAS § 601: 220, page 2.

pipeline a pass-through of the price the pipeline pays for 107 gas, but *only* if FERC can prove that the price results from "fraud, abuse or similar grounds." Moreover, FERC's power to deny a pipeline a pass-through can be exercised *only* against the pipeline and *only* when (and if) the pipeline comes before FERC to obtain authority to pass-through the entire price paid by the pipeline and include that price in the resale rates charged by the pipeline to consumers. However, FERC still has no authority or jurisdiction (not even under Section 601(c)) to regulate or control a pipeline's purchase of 107 gas, or the price the pipeline pays to producers or the pipeline's contract with the producers.

The Court's inquiry into the preemption claims raised by Transco merits a brief sub-section by sub-section analysis of just how Congress used Section 601 to free the producers and pipelines from the NGA and FERC's NGA-jurisdiction to control purchases and sales of 107 gas, contract terms and prices paid by pipelines for 107 gas. This analysis is relevant to the claim that *Northern Natural* applies in this case.

First, Congress included Section 601(a)(1) to eliminate the NGA requirement that the parties had to first obtain from FERC a certificate of public convenience and necessity as to new gas, and to remove FERC's jurisdiction and power to set a "just and reasonable" price and dictate contract terms. Section 601(a)(1) provides that the first sale of undedicated gas is never made subject to the NGA or FERC's NGA-jurisdiction.[9] The *effect* of this particular sub-section is that neither the producer nor the pipeline ever has to obtain the previously required certificate of public convenience and necessity in order to sell

---

[9]NGAP § 601(a)(1)(A)&(B); Joint Explanatory Statement of the Committee on Conference of the House and Senate. *Accord, Pennzoil Co. v. FERC*, 645 F.2d at 380.

and buy this type of new gas.[10] Because the parties do not have to obtain a certificate from FERC, FERC cannot use its NGA power (to grant or deny a certificate) to control purchases, contract terms and price, as it did prior to enactment of the NGPA and at the time *Northern Natural* was decided.[11] Nor can FERC, pursuant to its NGA jurisdiction over a "natural gas company," control the price which a pipeline like Transco pays for the gas on the grounds that Transco is an otherwise regulated "natural gas company." Section 601(a)(1)(D) provides that Transco shall not be considered to be a "natural gas company" with respect to its purchase of Section 107 gas.

Second, Congress included Section 601(b) and (c) to protect a pipeline from an after-the-purchase attack by FERC on the price which the pipeline pays for Section 107 gas. Section 601(b) provides that all prices which the pipeline pays for Section 107 gas are deemed "just and reasonable" as a matter of law, and Section 601(c) provides that the pipeline has the guaranteed statutory right to pass-through the price which it pays

---

[10]*See*, e.g., *Conoco, Inc. v. FERC*, 662 F.2d 796, 797, 799 (5th Cir. 1980). *See also* FERC's Preamble to the issuance of the first interim regulations issued after the NGPA was passed, 43 F.R. 56448 (12-1-78), wherein FERC observed the effect of the NGPA on the NGA:

> "If gas is not committed or dedicated to interstate commerce . . . or is exempted from the jurisdiction of the NGA under section 601(a)(1)(B) as [107 or 102 or 103 gas] the prior framework of utility-type regulation under the NGA no longer applies.
>
> If natural gas sales are freed from the requirements of the NGA, several adjustments to NGA regulation are obviated. First, there is no longer any necessity for a producer to seek certification of the sales as serving the public convenience and necessity." *Id.*

[11]*See*, e.g., *Pennzoil Co. v. FERC*, *supra*, in which the Fifth Circuit held that FERC no longer has jurisdiction to regulate or interpret gas purchase contracts covering undedicated gas or dedicated gas which is also 107 or 102 or 103 gas: "In other words, section 601(a)(1)(A) prevents the universe of gas subject to the NGA from expanding." 645 F.2d at 380.

for Section 107 gas and include that price in its resale rates charged to consumers.[12]

A pipeline can be denied its guaranteed statutory right to pass-through the price paid to producers *only* if FERC finds that the price results from "fraud, abuse or similar grounds." *See* Section 601(c)(2). That particular determination can be made *only* in rate proceedings before FERC in which the pipeline seeks authority to pass-through the Section 107 price and include that price in its resale rates to consumers. FERC can deny the pipeline a pass-through of *only* that portion of the Section 107 price which results from "fraud, abuse or similar grounds." However, FERC still has no jurisdiction or authority to prevent the pipeline from purchasing 107 gas or paying deregulated prices to the producer, as it could at the time *Northern Natural* was decided.

Thus, under Section 601(a)(1) (A) and (B) the entire first sale transaction of new gas is removed from the NGA and FERC's NGA-jurisdiction, and, to drive home the point, Section 601(a)(1)(D) further removes the former NGA-jurisdiction given FERC by NGA Section 2(b) by declaring that the pipeline purchaser is *not* a "natural gas company" with respect to its purchase of new gas. Because a "first sale" means the *entire* first sale transaction (both the producer's "sale" and the pipeline's "purchase"), neither the producer nor the pipeline is subject to FERC's NGA-jurisdiction with respect to a first sale of this gas. The practical effect of Section 601(a) (1) is that FERC cannot prevent, regulate or control a pipeline's purchases and takes of Section 107 gas nor the price which the pipeline pays for that gas; FERC cannot directly or indirectly regulate, control or dictate the contractual terms on which the gas is to be sold and purchased; the pipeline and the producers do not ever have to obtain FERC's approval of the price paid by the pipeline; and the pipeline and the producers do not ever

---

[12]*See*, e.g., *Pennzoil Co. v. FERC*, 645 F.2d 360, 379 (5th Cir.): "Section 601(c)(2) guarantees to interstate pipelines the ability to pass through NGPA payments."

have to obtain a certificate of public convenience and necessity from FERC in order for the pipeline to be able to buy the gas and bring it into the interstate market. Needless to say, this is a vastly different regulatory scheme from that which was in existence under the NGA when *Northern Natural* was decided.

As it relates to the Rule 48 issue now before the Court, because the NGPA now exempts the first sale of 107 gas from the NGA and FERC's NGA-jurisdiction, then Statewide Rule 48 and Order No. 409-82, which apply to only the wellhead "first sale" of 107 gas, do not conflict with, invade, nor infringe upon FERC's NGA-jurisdiction. The NGA-jurisdictional reasons why the Supreme Court voided the ratable take order in *Northern Natural* no longer exist as to Section 107 gas. As to 107 gas, the State is therefore free to re-enter the limited area which it was allowed to regulate under *Cities Service Gas Co. v. Peerless. supra.*

Thus, the Court concludes that Statewide Rule 48 and Order No. 409-82 do not regulate or invade areas or matters which have been preempted by the NGA or the NGPA.

2. The Commerce Clause, Due Process Clause and Equal Protection Clause Claims

The constitutionality of a ratable take/minimum price order similar to Order No. 409-82 was upheld in *Cities Service Gas Company v. Peerless Oil & Gas Company,* 340 U.S. 179 (1950), a case in which the Supreme Court rejected the same type of due process, equal protection and commerce clause arguments which Transco has assigned as errors. The plaintiff in *Peerless* found itself in somewhat the same factual situation as Coastal. There, Peerless had no pipeline outlet of its own and was being drained by production from offsetting wells from which Cities Service, an interstate pipeline company, was purchasing gas. Peerless offered to sell the gas from its wells to Cities Service but Cities Service refused to take the gas unless Peerless would dedicate all of its gas at a price which was lower than that being paid to other owners in the field. The Oklahoma Corpora-

tion Commission ordered Cities Service to purchase gas from Peerless ratably and at not less than a minimum price which was fixed by the Commission. On appeal, first to the state courts and then to the Supreme Court, Cities Service claimed that the state could not engage in "price fixing" and that the ratable take order violated the due process, equal protection and commerce clauses. The Supreme Court upheld the ratable take/minimum price order and rejected all of Cities Service's constitutional claims. *Id.* 340 U.S. at 185-188, 71 S.Ct. at 219. Only recently, the Supreme Court cited *Peerless* for the proposition that the states have the power to regulate natural gas prices and sales as long as that regulation does not interfer with interstate commerce. *See, Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 103 S.Ct. 697 (1983), an NGPA case.

One of Transco's principal constitutional arguments is that Rule 48 and Order No. 409-82 are unconstitutionally vague. This vagueness claim was not raised by Transco at trial. Although ratable take statutes, rules, and orders are seldom construed by appellate courts, the applicable case law and the facts refute Transco's assertion that Rule 48 and Order No. 409-82 are unconstitutionally vague. The decisions indicate that the task of compliance with a ratable take order can be worked out between the state entity issuing the order and pipeline to whom it is directed.

In *Railroad Commission v. Rio Grande Valley Gas Company*, 405 S.W. 2d 304 (Tex. 1966), Rio Grande asserted that an order of the Texas Railroad Commission, issued pursuant to the Texas Common Purchaser Act, requiring Rio Grande to extend its gathering line to a particular well and to "connect said well and to take gas therefrom without unjust or unreasonable discrimination in favor of its own [Rio Grande's] production or that of any other producer in said field area and without unjust or unreasonable discrimination," was fatally defective because it did not with sufficient certainty inform Rio Grande as to the price it was to pay for the gas in question or as to the quantity of gas Rio Grande was to take from the well. The

Texas Supreme Court upheld the validity of the order, noting that "the provisions of the order follow the statute. Neither price nor quantity of take are prescribed. This does not mean that such factors may not be ascertained." (*Id.* at 311).

The Texas Supreme Court also made the following observations:

> Ordinarily, the question of price is one to be settled by agreement of the parties, and it is not the function of the Commission primarily to set a well head price per MCF. The same may also be said as to the amount of gas to be taken from any particular purchaser. However, in the absence of agreement as to these items, it then becomes the primary duty of the common purchaser to devise in good faith a formula, which will be undiscriminatory as to price and ratable take among the various producers in the field. . . (Citations omitted). Once the common purchaser has in the absence of agreement set a price, the question of the good faith of the purchaser and the reasonableness of the basis chosen by it in setting the price may present a question for the Railroad Commission. Primarily, what the order of the Commission does in this case is to determine that Rio Grande is a common purchaser and that as such it must take gas from the Maguire Well in accordance with statutory provisions proscribing discrimination. *The order adopted by the Commission is in proper form to meet the situation as it has so far developed.* It remains to be seen whether further or additional orders will be required. (Emphasis added). (*Id.* at 312).

The applicable provisions of the Texas Common Purchaser Act, which are set forth in *Rio Grande, supra*, provide that a common purchaser of gas "shall purchase [gas] offered to it for purchase without discrimination in favor of one producer or person as against another in the same field." (*Id.* at 308). The provisions of Statewide Rule 48 as promulgated by the Mississippi Oil and Gas Board are very similar.

The United States Supreme Court has also decided that a state ratable take order, although couched in general language, presents no constitutional infirmities regarding vagueness. The Court considered the vagueness issue in *Phillips Petroleum Company v. Oklahoma*, 340 U.S. 190, 95 L.Ed. 204, 71 S.Ct. 221 (1950), a companion case to *Cities Service Gas Company v. Peerless Gas & Oil Company*, 340 U.S. 179, 95 L.Ed. 190, 71 S. Ct. 215 (1950), which, as discussed *supra*, upheld the constitutionality of ratable take statutes and orders. The contention of Phillips was that the ratable take orders issued by the Oklahoma Corporation Commission were unconstitutionally vague. To this assertion the Supreme Court replied:

> In substance, this argument is nothing more than that the determination by an integrated company of proceeds realized from gas at the wellhead involves complicated problems in cost accounting. These problems are common to a host of valid regulations. There is nothing to indicate that Phillips will be penalized for reasonable and good faith efforts to solve them. (340 U.S. at 192).

With respect to the instant case, there is nothing confusing or mysterious about the operation of Statewide Rule 48 or, more specifically, Order No. 409-82. The language of the rule is sufficiently definite to put a purchaser on notice that it shall "purchase without discrimination" within a common source of supply or pool. In the proceedings before the Board, Transco did not contend that it did not understand what Rule 48 meant or required.

Additionally, it is no secret that Transco was aware of the existence of Rule 48 when it first sought to purchase gas from the Greens Creek and East Morgantown Fields. During the Oil and Gas Board hearing, the following discussion took place between Chairman Fancher and Tricia Pollard, Senior Gas Contract Representative for Transco:

> By Chairman Fancher: Okay. Let me ask you a question. When Transco enters into a Gas Purchase Contract, are they aware of the Rule 48?

ANSWER: Yes, sir, when we contract to buy gas in any state, we buy it subject to the rules in the state. Just like when we sent out the letter requesting that the operators cut back to only the gas which was under contract to us.

By Chairman Fancher: Yes, that's all very good, but what about ratable taking without discrimination? When you come in here to purchase gas don't you realize that your contract is subject, and that your purchasing and your distribution and sale of gas, is subject to Rule 48? If the rule is any good it's part of your contract, isn't it? Or at least your operations are subject to it, are they not?

ANSWER: That's correct.

(*Transcript*, at 252-53).

Nor is Order No. 409-82 vague. It contains extensive and specific findings of fact and, as to the discrimination issue, finds that on and after July 1, 1982 Transco has discriminated against Coastal by first refusing to buy Coastal's gas at all, and then offering to buy Coastal's gas on different terms and conditions and at a different and much lower price than that at which Transco proposed to continue buying Getty's and Tomlinson's share of gas from the same pool. The evidence established that the difference in the price ($5.00 per MMBTU) and the terms offered to Coastal, when measured by the price ($7.90 per MMBTU) and the terms extended to Getty and Tomlinson, was discriminatory against Coastal and in favor of Getty and Tomlinson. After taking note of this discrimination, Order No. 409-82 orders Transco to purchase without discrimination. This leaves no reasonable man with any doubt but that Transco, if and when it chooses to buy gas from the pool, shall buy Coastal's gas on the same terms and conditions as it buys Getty's and Tomlinson's gas.

3. The Claim of Taking of Private Property for Private Use Without Compensation

Order No. 409-82 does not constitute a taking of private property for private use without compensation. This notion

was disposed of in *Cities Service Gas Co. v. Peerless Oil & Gas Co., supra.* In that case Cities Service asserted:

> The application thus given to the statute under the relevant facts in the record deprives appellant of its property for the private use and benefit of the royalty owners and certain producers, and is taking of property without due process of law, forbidden by the Fourteenth Amendment. (95 L.Ed., at 194).

The Supreme Court rejected this argument, stating:

> The Due Process and Equal Protection issues raised by appellant are virtually without substance. It is now undeniable that a state may adopt reasonable regulations to prevent economic and physical waste of natural gas. This Court has upheld numerous kinds of state regulation designed to curb waste of natural resources and to protect the correlative rights of owners through ratable taking, *Champlin Refining Co. v. Corporation Commission*, 286 U.S. 210, 76 L.Ed. 1062, 52 S.Ct. 559, 86 ALR 403 (1932), or to protect the economy of the state. *Railroad Commission v. Rowan & Nichols Oil Co.*, 310 U.S. 573, 84 L.Ed. 1368, 60 S.Ct. 1021 (1940). These ends have been held to justify control over production even though the uses to which property may profitably be put are restricted. *Walls v. Midland Carbon Co.*, 254 U.S. 65, L.Ed. 276, 41 S.Ct. 118 (1920).
>
> Like any other regulation, a price fixing order is lawful if substantially related to a legitimate and sought to be attained. *Nebbia v. New York*, 291 U.S. 502, 78 L.Ed. 940, 54 S.Ct. 505, 89 ALR 1469 (1934) and cases therein cited. (340 U.S., at 184-85).

Order No. 409-82 takes no property from Transco. It merely requires that, if and when Transco elects to take gas from the pool in question, Transco must take the quantities it needs ratably from the wells and producers in those wells who want to sell their gas, and purchase that gas without discrimination.

While Transco is free to reach agreements with producers on the terms and price to be paid for the gas, Rule 48 ensures that a producer who wants to sell his gas is not required to sell it at a discriminatory price.

II. STATE LAW CHALLENGES

Transco has asserted that since Statewide Rule 48 is directed toward purchasers of oil and gas, the Oil and Gas Board, which Transco asserts is empowered to regulate only the production of oil and gas, cannot, in the absence of a ratable take statute, promulgate a ratable take rule. To the contrary though, the Court finds that Statewide Rule 48 was promulgated pursuant to the Board's express statutory authority to prevent waste and protect the co-equal and correlative rights of the owners in a common pool, and the state's inherent police powers (delegated to the Board) to protect its producers from discriminatory purchasing practices and to condition the right to conduct business in this state.

Mississippi Code Annotated Section 53-1-1 (1972) declares that it is the policy of the State of Mississippi to:

> . . . protect the public and private interests against the evils of waste in the production and utilization of oil and gas, by prohibiting waste as herein defined; to safeguard, project and enforce the coequal and correlative rights of owners in a common source or pool of oil and gas to the end that each such owner in a common pool or source of supply of oil and gas may obtain his just and equitable share of production therefrom[.] (Emphasis added).

Section 53-1-3(k) (3), Mississippi Code Annotated (Supp. 1982) defines "waste" as:

> Abuse of the correlative rights and opportunities of each owner of oil or gas in a pool due to non-uniform, disproportionate, or unratable withdrawals causing undue drainage between tracts of land or resulting in one or more owners in such pool producing more than his just equitable share of the production from such pool.

Section 53-1-17 empowers the Board to adopt "reasonable rules, regulations and orders" as may be necessary to implement the stated purposes and legislative intentions of the conservation laws of this state. The purposes of those rules expressly include the prevention of "waste" as defined by Section 53-1-3, and the prevention of "reasonably avoidable drainage from each developed unit which is not equalized by counterdrainage."

Statewide Rule 48 provides as follows in its entirety:

> Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, or producers shall purchase without discrimination in favor of one owner, operator, or producer against another in the same common source of supply.

At the oral argument of this case, counsel for the parties agreed that Statewide Rule 48 has been on the books of the Board for over thirty (30) years, having been promulgated shortly after passage of the 1948 Conservation Act. This type of rule is sometimes referred to as a "common purchaser rule" and is in force and effect in one form or another in most of the oil and gas producing states in this country, including Oklahoma, Kansas, New Mexico, Florida, North Carolina, Colorado and Louisiana. All of these statutes and rules are designed to protect the co-equal and correlative rights of the owners in a common pool so that each owner has the opportunity to receive his proportionate share of production, and to protect producers from discriminatory purchasing practices and the unequal bargaining position which generally exists between a purchaser and the owners of small undivided interests in a pool. As set forth in *Summers on Oil and Gas*, Volume 1A, Section 103.1 at 132:

> The mere opportunity of a land owner to take his share of the oil and gas in common source of supply does not provide complete protection of his property rights in them. If others produce and market, he must also produce and market or loose much of his share through drainage

> and the exhaustion of reservoir energy. He cannot produce and market unless a market outlet is available. To provide market outlets for both oil and gas a few states have enacted common purchasers statutes requiring common carrier pipelines or other persons in the business of purchasing oil and gas in a common source of supply to take ratably from all owners.

The Mississippi Supreme Court has repeatedly upheld the rule-making powers of the Oil and Gas Board, particularly where a rule of the Board was for the purpose of preventing waste and protecting the co-equal and correlative rights of the owners in a common pool of oil and gas. In *Superior Oil Company v. Foote*, 59 So.2d 85 (Miss. 1952), the Mississippi Supreme Court, in upholding the validity of the compulsory pooling statute, made the following observations:

> . . .The police power of the State includes not only regulations to promote public health, good morals, and good order, but also the right to regulate and promote development of industry and utilization of natural resources in order to add to the wealth and prosperity of the State. (Citations omitted). Hence the courts have consistently held that the State may enact regulatory laws for and prescribe methods of extracting oil and gas for the purposes of conservation, the efficient use of reservoir energy, and the protection of the correlative rights of all owners in a common source of supply. But the statute must not be arbitrary or unreasonable, and the regulation must have a direct, substantial, and reasonable relation to the statutory purpose. *Miss. Const. of 1980*, Sect. 16, provides that "laws impairing the obligation of contracts, shall not be passed." The U.S. Const., Art. I, Sec. 10, cl. 1, has a somewhat similar provision. However, it is well established that this provision is qualified by a proper exercise of the police power of the state. . . Hence it is said that all contracts and property rights are subject to a reasonable exercise of the police power. (*Id.* at 93).

In *California Co. v. State Oil and Gas Board*, 27 So.2d 542 (Miss. 1946), the Board promulgated oil well spacing rules for the Cranfield Field in Adams County, and granted exceptions to those rules. The Mississippi Supreme Court ruled that the well spacing rules and the Board's power to grant exceptions to those rules were valid. Also of interest is *Barnwell, Inc. v. Sun Oil Co.*, 162 So.2d 635 (Miss. 1964) the Board's adoption of "special field rules" for a gas field was challenged on the grounds that there was no expressed statutory authority. However, the court upheld the Board's order as a valid exercise of the Board's police power, commenting that:

> The police power of the state includes not only regulations to promote public health, good morals and good order, but also the right to regulate and promote the development of industry and utilization of natural resources in order to add to the wealth and prosperity of the state. . . The police power of a sovereign state does not find its source in the written constitution of the state, it is a power inherent in the existence of a sovereign government. (162 So.2d at 641).

Transco contends that because the Mississippi conservation laws are directed exclusively toward producers, Rule 48 does not have the "direct, substantial, and reasonable relation to the statutory purpose" necessary to pass judicial scrutiny. Transco has stated that the Board should instead allocate production from the Greens Creek and East Morgantown Fields according to market demand. Transco cites Section 53-3-9(a), Mississippi Code Annotated (1972) for this proposition. This section states:

> Whenever the state oil and gas board has fixed for the purpose of preventing waste, as defined in section 53-1-3, the total amount of oil or gas which may be produced in any pool in this state at an amount less than that amount which the pool can produce, the board shall allocate or apportion the allowable production among the producers in the pool on a reasonable basis so as to prevent reasonably avoidable drainage from each developed unit which is

> not equalized by counter-drainage, and so that each producer will have the opportunity to produce or receive his just and equitable share, as above set forth.

While it is true that the Oil and Gas Board can determine allowables from a common source of supply, the Board has no authority to proration such production according to market demand, as Transco suggests. Indeed, the Board is expressly prohibited from doing so. Section 53-1-1, Mississippi Code Annotated (1972), states:

> *It is not the intent nor the purpose of this law to require or permit the proration or distribution of the production of oil and gas among the fields and pools of Mississippi, on the basis of market demand.* It is the intent and purpose of this law to permit each and every oil and gas pool in Mississippi to be produced up to its maximum efficient rate of production, subject to the prohibition of waste as herein defined and subject further to the enforcement and protection of the co-equal and correlative rights of the owners of a common source of oil and gas, so that each common owner may obtain his just and equitable share of production therefrom. (Emphasis added).

The mandate of the Oil and Gas Board is to prevent waste. If a purchaser's discriminatory purchasing practices cause waste by creating a situation where gas migrates *from* a gas unit from which the purchaser is purchasing less than that unit's allowable production *to* a gas unit from which the purchaser is purchasing that well's entire allowable production, the Board has the duty to intervene and protect those producers whose unit is being drained by unratable taking.

Transco has asserted that the Board's power to prevent waste is limited to the enumerated measures given to it by statute. It cites *Dobson v. Arkansas Oil & Gas Commission*, 235 S.W.2d 33 (1950), for the proposition that "where express powers are granted, the Board cannot adopt substituted measures no matter how desirable." This statement ignores the

plain language of Section 53-1-17(c), Mississippi Code Annotated (Supp. 1982), which states:

> The board shall have the authority, and it shall be its duty, to make, after notice and hearing as hereinafter provided, such reasonable rules, regulations and orders as may be necessary from time to time in the proper administration and enforcement of the provisions of sections 53-1-1 through 53-1-47, inclusive, and sections 53-3-1 through 53-3-21, inclusive, and to amend the same after due notice and hearing, *including but not limited to*, rules and regulations and orders for the following purposes. . . . (Emphasis added).

This statutory language makes it plain that the legislative intent was to clothe the Board with such implied powers as are necessary to prevent waste and to protect the co-equal and correlative rights of producers.

Clearly, the Board's general statutory powers to prevent waste and enforce the co-equal and correlative rights of the owners in a common pool; the Board's express statutory powers to prevent the abuse of the co-equal and correlative rights of the owners in the pool due to unratable withdrawals from a common pool; and the Board's inherent police power, derived from the delegation of that power by the Legislature to the Board, to protect producers from discriminatory purchasing practices and condition the right of purchasers to take oil and gas from this state, empowered the Board to originally adopt Statewide Rule 48 over thirty years ago. As the Mississippi Supreme Court stated in *Mississippi Public Service Commission v. Chambers*, 108 So.2d 550, 554 (Miss. 1959);

> It is the general rule that when a public board such as the Mississippi Public Service Commission is granted certain enumerated powers, there is usually conferred the implied power that may be reasonably necessary to the performance and exercise of the powers expressly granted. 108 So.2d at 554.

It is important to recognize that Rule 48, like the common purchaser rules in other states, lawfully conditions the right of a purchaser to conduct its business of taking and purchasing gas from a common pool in this state. While a purchaser is free to take no gas from a pool or only such quantities of gas as it desires, and is free (at least, initially) to determine the price which it will pay, if the purchaser elects to take gas from the pool, then the purchaser must take and purchase without discriminating among the producers in the pool. Of course, a purchaser and a producer can freely agree to any terms of sale and a producer can agree to sell on "discriminatory" terms; however, under Rule 48 a producer can not be forced to accept a discriminatory price in lieu of not having his gas purchased at all.

It is firmly established that a state has the inherent right to condition the right to conduct a business. For example, in *Nebbia v. People of State of New York*, 291 U.S. 502 (1934), the Supreme Court upheld the constitutionality of state milk control acts which regulated the milk industry and, among other things, fixed the minimum prices for milk:

> The constitution does not guarantee the unrestricted privilege to engage in a business or to conduct it as one pleases. Certain kinds of business may be prohibited; and the right to conduct a business, or to pursue a calling, may be conditioned. Regulation of a business to prevent waste of the state's resources may be justified. * * * So far as the requirement of due process is concerned, and in the absence of other constitutional restrictions, a state is free to adopt whatever economic policy may reasonably be deemed to promote public welfare, and to enforce that policy by legislation adapted to its purpose.* * * The constitution does not secure anyone the liberty to conduct his business in such a fashion as to inflict injury upon the public at large, or upon any substantial group of people. 291 U.S. at 528-29, 537-39.

Nebbia, and the power of a state to condition the right to conduct a business, was recently reaffirmed in *New Motor Vehicle Board of California v. Orrin W. Fox Co.*, 439 U.S. 96 (1978).

The Mississippi Supreme Court has likewise affirmed the principal that a state has the inherent police power to condition the conduct of a business in this state. Thus, in *Mississippi Milk Commission v. Vance*, 129 So.2d 642 (Miss. 1961), the Mississippi Supreme Court upheld the constitutionality of the Mississippi Milk Control Act which, among other things, authorized the Mississippi Milk Commission, a regulatory board to that industry what the Oil and Gas Board is to the oil and gas industry, to regulate and fix the minimum prices of milk sold in this state. The Act was upheld on the grounds that it was a reasonable exercise of the police power of the state and "the police power takes precedence over all private rights even though they stem from constitutional basis." *Id.* at 660.

Thus, it is clear that Transco has never had an unqualified constitutional right to buy gas from a pool in this state. Transco's right to buy gas from a pool in this state is subject to conditions imposed by this state pursuant to either express statutory authority or the inherent police power of the state. The condition which has been imposed upon the "right" of a gas purchaser in this state to purchase from a pool of oil or gas is that the purchaser "purchase without discrimination in favor of one owner, operator or producer against another in the same source of supply."

While not necessarily controlling of the question of the Board's state authority for adopting Statewide Rule 48, the Court believes that it is highly relevant to consider what can only be deemed to be legislative acquiescence in and ratification of Statewide Rule 48. As counsel for all parties have conceded, Statewide Rule 48 has been a rule of the Board for over thirty (30) years. Yet, during that time, the Legislature has not indicated its disapproval of the rule. During the 1982 legislative session, the State Oil and Gas Board underwent

"sunset review" pursuant to Mississippi Code Annotated Section 5-9-9(4), as required by the Mississippi Agency Review Law of 1978, Mississippi Code Annotated Sections 5-9-1 et seq (Supp. 1982), thereby necessarily entailing a legislative review of, *inter alia*, "all powers, duties and functions currently performed by" the Board, and "all constitutional, statutory, or other authority under which said powers, duties and functions" of the Board are carried out. Mississippi Code Annotated Section 5-9-19(b) (c). After this review, the Legislature voted to continue the Board in effect. *See* Chapter No. 485 House Bill No. 473, approved April 23, 1982. In doing so, the Legislature did not indicate its disapproval of Statewide Rule 48.

During the most recent 1983 legislative session, and in what may have been a response to the present challenge to the Board's authority to adopt Statewide Rule 48, the Legislature amended Mississippi Code Annotated Section 53-1-17 to include the following provision:

> (f) The board shall continue to have the power to make rules, regulations and orders necessary to prevent and protect against discrimination and the purchase, production and sale of oil and gas and against the unratable withdrawal of same, *including as provided for in Statewide Rule 48*. (Emphasis added).

This most recent legislative enactment, coupled with the longstanding nature of this rule, is persuasive evidence of the legislative acquiescence in and affirmative ratification of Statewide Rule 48 as a reasonable exercise of the Board's express and implied statutory powers and inherent police powers originally delegated to it by the Legislature in the course of enacting the Conservation Act of 1948. The viable concept of legislative acquiescene in and ratification of a longstanding rule of an administrative agency as being within the agency's powers was most recently reaffirmed by the United States Supreme Court in *Bob Jones University v. United States*, No. 81-3 (U.S. S.Ct. May 24, 1983), and that concept is equally applicable here as supporting the conclusion that the Board was vested with

ample authority as a matter of state law to adopt Statewide Rule 48 and issue Order No. 409-82.

III. THE CLAIMED PROCEDURAL AND EVIDENTIARY ERRORS

In its Assignments of Error 1 through 3, Transco contends that the Board erred in a variety of evidentiary rulings; that the Board was arbitrary and capricious in finding that Transco was discriminating against Coastal et al. in violation of Statewide Rule 48; and that the Board's Order No. 409-82 is not supported by substantial evidence.

In considering these assigned errors, the Court is mindful of the applicable standard of judicial review of an order of the State Oil and Gas Board:

> Whether the order is supported by substantial evidence, is arbitrary or capricious, beyond the power of the Board to make, or violates some constitutional right of complaining party.

California Co. v. State Oil & Gas Board, 200 Miss. 824, 842, 27 So.2d 542, 546 (1946); *Masonite Corp. v. State Oil & Gas Board*, 240 So.2d 446, 448 (Miss. 1970); *Damson Oil Corp. v. Southeastern Oil Co.*, 370 So.2d 225, 229 (Miss. 1979). The findings of an administrative agency like the Board are prima facie correct and the reviewing court may not substitute its judgment for that of the administrative agency where there is a substantial basis in the evidence for the findings. *Barnwell, Inc. v. Sun Oil. Co.*, 162 So.2d 635 (Miss. 1964).

1. The Claimed Evidentiary Errors

The trial before the Board was conducted in accordance with the Board's "Rules of Order and Procedure for Hearings Before the Board." Rule 13(c) thereof provides as follows:

> The materiality, relevancy and competency of any testimony shall be subject to challenge by any party to the hearing or by any member of the Board. When so interposed, such objections shall be acted upon by the Chair-

man or by the acting Chairman, his ruling thereon being subject to change by a majority vote of Board members then sitting.

The issue before the Board was whether Transco was violating Statewide Rule 48 and the conservation laws which prohibit waste. The two factual questions before the Board were fairly simple: (1) Was Transco taking gas unratably from the wells producing from the Harper Sand Gas Pool so as to cause or threaten to cause "waste"? (2) Was Transco discriminating against Coastal et al. and in favor of Getty and Tomlinson in Transco's purchases and takes of gas from that pool?

The record establishes that Transco never denied that it was in fact taking gas unratably from the wells producing the pool, and it admitted that it had, at first, refused to buy the gas of any producer, such as Coastal, who did not already have a gas purchase contract with Transco, and, subsequently, then offered to buy those purchasers' gas at a price which was substantially lower than the price which Transco would continue to pay Getty and Tomlinson, those producers' operators.

To what were almost exclusively undisputed facts on those two factual questions, Transco's defense was an explanation for why it was violating Statewide Rule 48 and state law by taking gas unratably and offering to pay the non-contract owners a discriminatory price: Transco believed that it might not make enough of a profit—or might in some point in the future lose money—if Transco had to pay the non-contract owners the same price which Transco was paying Getty and Tomlinson, those owners' operators. As interesting as Transco's excuse for violating the law might be, the fact is that the Board sustained various objections complained of on the grounds that the testimony or evidence sought to be aduced was speculative or was not relevant or material to the issues in the suit.

As an evidentiary matter, the rulings Transco complains of were made on the grounds that the question or proof were not relevant or material to the simple factual questions as to whether Transco was then violating Statewide Rule 48 and

committing waste. Some rulings went against Transco and some rulings went against Coastal et al. All the evidentiary rulings complained of called for the exercise of judgment and discretion by the Board, taking into consideration the issues. The Court finds that not one of the evidentiary rulings complained of constituted error, much less reversible error.

2. The Claim That the Board Acted Arbitrarily and Capricious In Fighting That Transco Was Discriminating Against Coastal

3. The Claim of Lack of Substantial Evidence

Transco's assignment of error 2 contends that the Board was arbitrary and capricious in finding that Transco was discriminating against Coastal et al. in violation of Statewide Rule 48. Transco's contention is that the Board could not find that Transco violated Rule 48 unless the Board found that Transco's discriminatory purchasing practices were "unreasonable" or "unjust." Transco's third assigned error is that the Order is not supported by subtantial evidence.

At the outset, the Court notes that the conservation statutes in general, and Statewide Rule 48 in particular, do not invite a person to comply with the law if it is convenient or profitable, and do not excuse a violation of the law because the violator believes he is acting "reasonable" or "just." These laws require that person, including Transco, comply with the law. The Board was not required to find that Transco was "unjustly" or "unreasonably" violating the conservation laws and committing waste before it could order Transco to comply with Statewide Rule 48 and stop the waste. The questions were whether Transco was taking gas unratably so as to cause waste, regardless of whether the waste was "reasonable" or "unreasonable", and whether Transco was in fact discriminating against Coastal et al. in favor of the operators, regardless of whether the discrimination was "reasonable" or "unreasonable".

The evidence that Transco was proposing to take gas unratably from the wells producing from the pool so as to cause or result in "waste," including undue drainage between tracts of land, is unrefuted. On May 19, 1982, Transco informed Getty by letter that:

> Effective June 1, 1982, Transco will only take production attributable to the pro rata working interests of the above named signatory parties under the various Getty wells, and until further notice will no longer take any gas being sold by the operator under the Operating Agreement. [Transcript at 49].

After negotiations with Getty, Transco agreed to delay implementing this decision until July 1, 1982. After July 1, however, Transco reduced its takes in this manner. The testimony of Ray Corcoran, Gas Activities Manager for Getty Oil Company, clearly described what occurred:

Q. (Mr. Watters) (for Getty)

I ask if you, Getty Oil Company, in fact, cut the production from the Getty operated wells in the Greens Creek Field and the East Morgantown Field insofar as they related to the Harper Sand Gas Pool after Transco advised them in May or June of 1982 that they should be cut?

A. Yes, we did cut to approximately 70 percent of the well deliverability and this was significantly lower than the June volume.

BY MR. WATTERS:

That's all the questions we have on rebuttal.

Cross Examination

BY MR. STEWART (for Transco):

Q. Mr. Corcoran, when was this production cut?

A. July 1.

Q. What wells were included in the production cut?

A. In the petition—

Q. No, sir, that's not my question. My question is: what wells were cut?

A. We cut all of the Getty operated wells.

Q. How many wells are operated by Getty in the area?

A. Four, with one well being on dual completion.

Q. This cut back to 70 percent includes—is the entire volume—a cut back of the entire volume—a cut back of the entire volume that Getty sold to Transco, is that correct.

A. Yes.

Q. And it also includes—

A. The entire volume in the Newsom, Greens Creek, East Morgantown.

Q. It includes gas that was being produced from other zones, isn't that correct?

A. No, the 70 percent is strictly the Harper Gas Pool.

Q. It does not include the lower zone in the Buckley Well?

A. That pool, the Hosston zone, was cut by the request of your letter.

Q. It was part of the 70 percent?

A. They were both cut 70 percent.

Q. And the cut backs of each well was not necessarily 70 percent though, was it?

A. Yes.

Q. Each well was cut back 70 percent—to 70 percent of its prior month's production?

A. The prior month's production—the 70 percent is of the well deliverability. From the prior month, it would probably be—I'm strictly estimating—probably would be 20 percent.

BY MR. STEWART:

No further questions.

BY MR. TAYLOR (for Coastal):

Q. Is Coastal's share of that gas part of that gas not being produced by the Getty well?

A. Yes, it is.

(*Transcript*, at 353-55).

Getty's reduction in deliveries in response to Transco's cutbacks could have but one result—unratable withdrawals between units. Because of the unratable withdrawals, the producers in the underproduced units would not receive their fair share of production. The undisputed testimony of Gerald Brautigam, who testified as an expert witness for Getty, established the effect of unratable withdrawals:

(BY MR. WATTERS):

Q. In other words, there is no geological feature which would prevent the Harkins Board of Supervisors 16-11 Well in Section 16, the Tomlinson Williamson Well in Section 21, the Florida Exploration Barnes 29-1 Well in Section 29, the Florida Exploration Carlisle 4-2 Well and other wells in the Harper Sand Gas Pool from draining hydrocarbons under the three Getty wells and the Tomlinson Willoughby 3-5 Well in the event the latter wells do not produce in sufficient volumes to offset drainage?

A. That is correct. If the three Getty wells and the Tomlinson Willoughby well are not produced at all, in time the other wells that are completed in the pool would significantly drain the unit in which these wells

are located. If the production from these four wells is lower than the production in the surrounding wells to an extent that drainage is not offset by counter-drainage, then these wells will not produce their co-equal and correlative share of hydrocarbons from the Harper Sand Gas Pool reservoir.

Q. What do you think is necessary for these wells to produce a share which will enable them to recover sufficient production to protect their co-equal and correlative rights of all parties owning an interest in these wells?

A. Well, in my opinion ratable production based on deliverability is necessary. In other words, if the other wells in the pool are producing at their maximum efficient rate of recovery, then these four wells should also be permitted to produce at their maximum efficient rate of recovery to prevent drainage.

* * *

Q. In your opinion if Transco is not required to take ratably from all wells in the field, would the co-equal and correlative rights of all parties owning an interest in this field be protected?

A In my opinion it will not. Without ratable production there will be undue drainage between the units. As a result the owners of interests in this [sic] units which are subject to this drainage will not be able to receive their fair share of hydrocarbons from the Harper Sand Gas Pool.

BY MR. WATTERS:

That's all the questions we have of this witness.

BY CHAIRMAN FANCHER:

All right, Mr. Stewart?

BY MR. STEWART (for Transco):

No questions.

(*Transcript*, at 152-54).

The evidence is clear and undisputed: Transco's unratable takes of gas from the wells producing from the pool was causing and threatening to cause undue drainage between tracts of land—drainage from the Getty and Tomlinson operated units to the Florida operated units—resulting in "waste" and in some owners in the pool receiving more than their fair share of gas. Thus, Board in this respect are not arbitrary and capricious.

With regard to the second question, of whether Transco was discriminating against Coastal et al. in favor of their operators, Getty and Tomlinson, the evidence is uncontradicted that Transco was in fact discriminating against Coastal and those other producers who had no contract with Transco but who wanted to sell to Transco. The evidence establishes that Transco at first refused to buy Coastal et al's gas at all. After Coastal filed its petition with the Oil and Gas Board, Coastal then received a letter from Transco in which Transco offered to buy Coastal's gas at a price which was substantially lower than the price which it would continue to pay to Coastal et al's operators, Getty and Tomlinson ($5.00 per MMBTU vs. $7.90 per MMBTU). To treat these producers differently, when their gas was being produced from the same pool through the same wells and with no qualitative difference from the gas of Getty and Tomlinson, is to discriminate against them in violation of Statewide Rule 48.

In contending that the Board acted arbitrary and capricious, Transco contends that the Board did not use a "standard of reasonableness" in determining what differences in terms and conditions equal discrimination of the kind that is prohibited by Statewide Rule 48. Rule 48 provides in relevant part that a purchaser shall purchase without discrimination "in favor of one owner, operator or producer against another in the same common source of supply." In determining whether Transco was in fact discriminating in violation of Rule 48, the Board determined the question of discrimination by reference to the

terms, conditions and price on which Transco was buying the operators' gas. This was a reasonable basis on which to determine the discrimination question. The evidence was uncontradicted that Getty and Tomlinson were the operators of the wells in question, and that for a period of over fifteen (15) months Transco had taken and paid for Coastal et al's gas produced from these wells on the same terms and conditions as Transco took and paid for the operators' gas produced from the wells, all of which was in accordance with what had been and was then the industry practice. Thus, the Board clearly had a reasonable basis for using the price which Transco was paying Getty and Tomlinson as the price for determining whether Transco's purchases from Coastal et al. at a much lower price would be discrimination within the prohibition of Statewide Rule 48.

* * *

Transco asserts that the producers failed to put on any substantial proof that Transco's "cut-back" of gas from the three wells was the cause of unratable drainage. However, as pointed out above, Getty's witnesses testified that Transco had forced Getty to reduce its deliveries, and that such a reduction in production would cause drainage from the Getty units to the neighboring Florida units from which Transco was taking all producers' gas.

Transco's own witness admitted that cut-backs from the Getty units would result in drainage to other units in the common pool. Tricia Pollard, of Transco, testified as follows during her cross-examination:

> Q. And factually, Transco is taking, for all practical purposes, the deliverability capacity of the Harkins wells in Greens Creek completed into what the Getty geologist testified as a pool common with the Harper Sand Gas Pool; Transco is taking deliverability capacity from those wells.
>
> A. Deliverability capacity, is that what you said?

Q. Yes. Let me rephrase it, if you are having trouble with that. In the Harkins wells completed into this same pool, according to the Getty geologist, is Transco refusing to take the gas of any non-signatory parties to the contract between Harkins and Transco?

A. No, I don't believe we are.

Q. So, that as to the Harkins wells Transco is not proposing to cut those wells back to only the interest of the signatory parties?

A. That's correct.

Q. Meaning that if Transco cut back the Getty wells to only the interest of the signatory parties, but continues to take all of the gas produced from the Harkins wells, regardless of whether it's the gas of the signatory parties, there will be disproportionate withdrawals of gas between the wells; yes or no?

A. Yes.

(*Transcript*, at 236-37).

Additionally, some sixty-four (64) pages of the transcript are devoted to testimony by petroleum geologists and reservoir engineers in regard to the geology of the Harper Sand Gas Pool in question and whether Transco was taking gas unratably among the wells producing from the pool so as to cause unit-to-unit drainage and waste. The testimony was clear and direct to the point that Transco's purchases and takes of only its contract parties' gas from the six wells in question was then resulting in unratable takes of gas and was causing and would cause unit-to-unit drainage, with the result that some owners in the pool would recover more than their fair and equitable share of gas.

When a court reviews a decision of an administrative body such as the Board, which sits as a trier of fact, the rule stated in *First National Bank of Vicksburg v. Martion*, 238 So.2d 856 (Miss. 1970), must be kept in mind. In that case, the Mississippi Supreme Court reversed a Chancery Court decision which had

overturned an order of the State Banking Board. The Court established this rule which applies to all administrative agencies which sit as triers of fact:

> On appeal from an order based upon a factual finding by a trier of facts, as the Banking Board was in this case, this Court accepts the evidence which supports or reasonably tends to support the conclusion upon which the order is based, together with all inferences favorable to it which reasonably may be drawn from the evidence. (*Id.* at 858).

The rule established in the *Martin* case commands a reviewing court to find that the Board's decision was indeed based upon substantial evidence. The testimony given to the Board established that Transco intended to reduce its takes from the Getty units, and that deliveries from the Getty units were reduced to comply with Transco's demands. The testimony supported the Board's conclusion that unratable taking would cause undue drainage between units.

It should also be noted that Transco bases its argument that the Board's Order was not supported by substantial evidence in part upon figures which were not made a part of the record at the Board's hearing. These numbers were put together by Transco after all testimony was heard and the parties had rested, when Transco attempted to offer these figures into evidence during its closing argument. The Board refused to allow Transco to enter this exhibit into evidence. (*Transcript*, at 357). Section 53-1-39, Mississippi Code Annotated (1972), provides that all appeals from an order of the Oil and Gas Board "shall be taken and perfected, heard and determined, either in term time or in vacation on the record, including a transcript of the pleadings and testimony, both oral and documentary, filed and heard before the Board."

The Board is empowered to prevent not only present waste, but also *imminent* waste. *See* Mississippi Code Annotated Section 53-1-17. Testimony which establishes that the effect of the unratable taking was and would be to cause undue drainage within and between units certainly conforms to the require-

ments of "subtantial evidence" sufficient to support the Board's findings of fact that Transco's unratable takes of gas was causing waste and drainage between units.

For the reasons set forth above, the Court finds that the Board did not act arbitrary and capricious, and that Order No. 409-82 is supported by substantial evidence.

CROSS APPEAL OF COASTAL

Coastal originally filed a cross-appeal in this case. However, at the oral argument of this case, counsel for Coastal stated that they did not wish to pursue the cross-appeal and would dismiss it. Thus, the Court does not need to address the assignments of error raised by the cross-appeal.

ORDER

For the reasons stated above in the foregoing Memorandum Opinion, IT IS THEREFORE ORDERED AND ADJUDGED AS FOLLOWS:

1. That the Motion to Strike Attempted Reservation of Federal Claims is sustained.
2. That State Oil and Gas Board Order No. 409-82 is affirmed in its entirety.
3. That the cross-appeal filed herein by Coastal is dismissed.
4. That all costs herein shall be and the same are hereby assessed against Transco.

SO ORDERED AND ADJUDGED on this 28 day of June, 1983.

REUBEN ANDERSON,
Circuit Judge

ATTEST A TRUE COPY
Wm. E. "BILL" McKINLEY,
CIRCUIT CLERK
JUNE 28, 1983

By Sharon M. Haley D.C.

APPENDIX C

BEFORE THE STATE OIL AND GAS BOARD OF MISSISSIPPI

IN RE: PETITION OF COASTAL EXPLORATION, INC. TO REQUIRE TRANSCONTINENTAL GAS PIPE LINE CORPORATION TO RATABLY TAKE AND PURCHASE WITHOUT DISCRIMINATION GAS PRODUCED FROM THE GETTY OIL COMPANY—ROGERS 28-11 WELL NO. 1, THE GETTY OIL COMPANY—SIPP 20-9 WELL NO. 2, AND THE TOMLINSON INTERESTS, INC.—WILLOUGHBY 3-5 WELL NO. 1 IN THE GREENS CREEK AND EAST MORGANTOWN FIELDS, MARION COUNTY, MISSISSIPPI

Docket No. 287-82-418
287-82-467

Order 409-82

FILED FOR RECORD
October 13, 1982
STATE OIL AND GAS BOARD
A. Richard Henderson, Supervisor

ORDER

This day this cause came on for hearing on the Petition of Coastal Exploration, Inc. ("Coastal") and the Joinder Petition of Wiley Fairchild, Rodney Fairchild, and W.R. Fairchild Construction Company, Ltd. (all of whom are hereinafter referred to as the "Fairchilds"), to require Transcontinental Gas Pipe

Line Corporation ("Transco") to comply with Statewide Rule 48 of the Rules and Regulations of this Board with regard to Transco's purchase of gas from a common source of supply in the Greens Creek and East Morgantown Fields of Marion County, Mississippi. The Board having considered the Petition, the responsive pleadings thereto, the evidence and testimony, and the argument of counsel thereon, finds that the Petition is well taken and should be granted.

The Board makes the following findings of fact:

1.

This Board has jurisdiction over the parties and the subject matter of the Petition. Lawful notice of the hearing of this matter has been given in the time and manner required by law and the proofs of publication are on file with this Board.

2.

The following wells are completed into and are producing from the Harper Sand Gas Pool which is a common source of supply ("common pool") of natural gas located in the Greens Creek and East Morgantown Fields of Marion County, Mississippi:

WELL	LOCATION	DATE OF FIRST GAS SALES FROM COMMON POOL
Getty Oil Company-Rogers 28-11 Well No. 1	§ 28-5N-19W Marion County, Miss. Greens Creek Field	April 1981
Getty Oil Company-Sipp 20-9 Well No. 2	§ 20-5N-19W Marion County, Miss. Greens Creek Field	October 1981

Tomlinson Interests Inc.-Willoughby 3-5 Well No. 1	§ 3-T4N-R19W, Marion County, Miss. East Morgantown Field	April 1982
Getty Oil Company-Buckley 33-6 Well No.1	§33-5N-19W, Marion County, Miss. East Morgantown Field	April 1981
Florida Exploration Company-Carlisle 4-2 Well No. 1	§ 4-T4N-R19W Marion County, Miss. East Morgantown Field	April 1982
Florida Exploration Company-Barnes 29-1 Well No. 1	§ 29-5N-19W Marion County, Miss. Greens Creek Field	July 2, 1982

3.

Coastal owns small undivided working interests in four of the foregoing wells which are completed into and producing from the said common pool, to-wit: In the "Rogers" well, a .0261220 leasehold working interest; in the "Sipp" Well, a .0066552 leasehold working interest; in the "Willoughby" Well, a .00468750 leasehold working interest; and in the "Barnes" Well, a .0015625 leasehold working interest. By virtue of its said ownership, Coastal owns and has the right to its fair and equitable share of gas produced from the common pool by the said wells. Coastal participated in drilling each of the said wells, voluntarily paid its share of drilling and completion costs, and has timely and regularly paid its share of operating costs.

4.

All of the wells which are completed into and produce from the said common pool have been classified by this Board as deep, high-cost wells under Section 107(C)(1) of the Natural Gas Policy Act of 1978 (NGPA).

5.

Transco heretofore entered into gas contracts with Getty Oil Company ("Getty") and Tomlinson Interests, Inc. ("Tomlinson") providing for Transco to purchase gas produced from the common pool by the said Rogers, Sipp, and Willoughby Wells, among other wells. Transco also contracted with Florida Exploration Company, the operator of the Carlisle and Barnes wells, to purchase all of the gas produced from the common pool by the Carlisle and Barnes Wells and tendered to Transco by the operator.

6.

From the date of first production from the common pool by the said wells, including the Rogers, Sipp and Willoughby Wells in which Coastal owns interests, and continuing until on or about July 1, 1982, each of the said wells (with the exception of the Florida-Barnes Well which did not begin production until July 2, 1982) produced at its maximum efficient rate of flow and Transco took ratably and purchased without discrimination among the owners in the wells all of the gas produced from the common pool by all of the wells, including Coastal's share of gas. Getty and Tomlinson, as the operators of the Rogers, Sipp, and Willoughby Wells, produced and delivered Coastal's share of gas to Transco and Transco took and purchased Coastal's share of gas on the same terms and conditions at the same price as Transco purchased the said operators' share of gas produced from the common pool by the said wells even though Coastal was not a signatory party to a written gas contract with Transco covering these wells. The operators sold Coastal's share of gas pursuant to the operators' authority under operating agreements and Transco took and purchased Coastal's share of gas on the same terms and conditions and at the same price provided for in the operators' contracts with Transco.

7.

In May 1982, Transco advised Getty that effective with production beginning on and after June 1, 1982 Transco would

no longer take or purchase that gas produced from the common pool by the Rogers and Sipp Wells which was attributable to the interest of Coastal and any other owners in the wells who were not signatory parties (those persons being referred to herein as "non-signatory owners") to gas contracts with Transco, but Transco would continue to take and purchase that gas produced from the common pool by the said wells which was attributable to the interest of the operators and other owners in the wells who were signatory parties to written gas contracts with Transco. At the request of Getty, this date was extended to July 1, 1982. Transco gave Tomlinson a like notice as to the Willoughby Well, to be effective August 19, 1982.

8.

Because of Transco's announced intention to refuse to continue to take and purchase Coastal's and the other non-signatory owners' share of gas produced from the common pool by the said wells, Getty notified Coastal and the other non-signatory owners that effective July 1, 1982 their gas would not be produced from the Rogers and Sipp Wells unless they obtained their own purchaser and their own gas contract. Tomlinson gave Coastal a similar notice as to the Willoughby Well, to be effective August 19, 1982.

9.

Coastal then requested Transco to continue to purchase Coastal's share of gas produced from the common pool by the said wells on the same terms and conditions as Transco purchased gas from the operators of the wells or to give Coastal a contract like Transco had given the operators; however, Transco refused to do so prior to the filing of the Petition in this docket. After the Petition in this docket was filed, Transco then offered to buy Coastal's gas (and the other non-signatory owners' gas) on terms and conditions different from those on which Transco had purchased Coastal's gas (and the other non-signatory owners' gas) prior to July 1, 1982, and different from those on which Transco was continuing to buy the operators'

gas. Two of the major differences were Transco's proposal to purchase Coastal's gas subject to a so-called "market-out clause" and at a price per MMBTU which was substantially lower than the price to be paid by Transco to the operators for the operators' share of gas produced from the same pool through the same wells. Coastal did not agree to this proposal because Coastal believed that the proposal discriminated against Coastal and violated Statewide Rule 48, and that Coastal could not be forced to accept a discriminatory piece and discriminatory conditions.

10.

Effective July 1, 1982 as to the Getty-Sipp and Rogers Wells, and effective August 19, 1982 as to the Tomlinson-Willoughby Well, Transco ceased to take and purchase gas attributable to Coastal's interest and the interests of any other nonsignatory owner in the wells until and unless an owner accepted Transco's different offer. As a result, Transco's takes of gas and the rates of production from the common pool by these wells were "cut back" to below the maximum efficient rate of flow of the wells so that, for all practical purposes, the wells produced only and Transco purchased only a rate of production equal to the operators' and other signatory parties' interest in the maximum efficient rate of flow from the wells. However, as to the Florida-Carlisle and Barnes Wells, Transco continued to take gas from these wells at, for all practical purposes, the maximum efficient rate of flow of the wells and to purchase the non-signatory owners' gas which was produced from these two wells and tendered to Transco by Florida, the operator, on the same terms and conditions and at the same price which Transco paid for the operators' gas produced from these two wells. Thus, while the Sipp, Rogers and Willoughby Wells were cut-back to below their respective maximum efficient rates of flow because of Transco's refusal to take and purchase gas, the Barnes and Carlisle Wells continued to be produced at their respective maximum efficient rates of flow because of Transco's takes and purchases of gas from those wells. The result has been and, if

allowed to continue, will be non-uniform, disproportionate and unratable withdrawals of gas from the common pool causing undue drainage between tracts of land, that is, drainage and undue drainage *from* the Getty and Tomlinson operated units producing from the common pool *to* the Florida operated units producing from the common pool. The result has also been and, if allowed to continue, will be one or more owners in the common pool producing more than their just and equitable share of the production from the pool.

11.

Transco's course of conduct has been to discriminate against the owners (like Coastal) of relatively small undivided working interests in the Sipp, Rogers and Willoughby Wells and the common pool produced by the wells simply because they are owners of relatively small undivided interests. From the date of first production by the wells until on or about July 1, 1982, Transco ratably took and purchased without discrimination the non-signatory owners' gas which was produced from the common pool and tendered to it by the operators on the same terms and conditions and at the same price at which Transco purchased the operators' gas produced from the wells. However, on and after July 1, 1982 in the case of the Sipp and Rogers Wells, and on and after August 19, 1982 in the case of the Willoughby Well, Transco has not ratably taken and purchased without discrimination from the common pool but in fact has discriminated in its purchases of gas from the common pool in favor of the operators and against Coastal, and the other non-signatory parties owning interests in these wells, by first refusing to purchase their gas at all, and then, after the Petition in this docket was filed, offering to purchase their gas but on different terms and conditions and at a different—and much lower—price than that at which Transco had been purchasing their gas and at which Transco proposed to continue purchasing the operators' share of gas produced from the common pool by these same wells. Transco's course of conduct since July 1, 1982 has simply been *not* to "purchase without discrimination

in favor of one owner, operator, or producer against another in the same common source of supply" as required by Statewide Rule 48 of this Board.

12.

The Board finds that Transco's refusal to ratably take and purchase without discrimination Coastal's share of gas produced from the said common pool from which Transco is purchasing the operators' gas produced from the common pool by very same wells and other wells completed into the common pool (1) is discriminatory in favor of the operators against Coastal and thereby violates Rule 48 of the Statewide Rules and Regulations of this Board; (2) constitutes "waste" as defined by Miss. Code Annot. § 53-1-3 because, among other things, it abuses the correlative rights of Coastal in the common pool, results in non-uniform, disproportionate and unratable withdrawals of gas from the common pool causing undue drainage between tracts of land, and will have the effect and result of some owners in the pool producing more than their just and equitable share of gas from the common pool to the detriment of Coastal; and (3) does not protect the co-equal and correlative rights of Coastal in the said common pool of gas, but violates, damages, and infringes upon Coastal's said rights. The Board further finds that such discrimination and waste should be prohibited.

13.

The Fairchild's Joinder Petition filed in this docket seeks for the Fairchilds the same relief sought by Coastal. The Fairchilds are owners of small undivided interests in the Getty-Rogers Well and, having no written contract with Transco, are in the same posture as Coastal, having received the same notices from Getty relative to Transco's refusal to continue purchasing their gas produced from the Rogers Well and having been offered the same type of different proposal as Transco offered Coastal. Therefore, the Board's findings set forth in paragraph 12 above also apply as to the Fairchilds' interests.

14.

Inexco Oil Company ("Inexco") has also made an entry of appearance in this docket pursuant to the statutes and the rules of this Board which liberally allow persons interested in the subject matter to be heard. Inexco is the owner of interests in the Rogers, Sipp, Willoughby and Carlisle Wells and, having no written contract with Transco, is in the same posture as Coastal, having received notices relative to Transco's refusal to continue purchasing Inexco's gas produced from the Rogers, Sipp and Willoughby Wells and having been offered the same type of proposal as Transco offered Coastal. Therefore, the Board's findings set forth in paragraph 12 above also apply as to Inexco's interests.

IT IS, THEREFORE, ORDERED AND ADJUDGED by the State Oil and Gas Board of Mississippi that Transcontinental Gas Pipe Line Corporation ("Transco") is hereby ordered immediately and forthwith to comply with Statewide Rule 48 of the State Oil and Gas Board of Mississippi in its purchases of gas from the said Harper Sand Gas Pool in Greens Creek and East Morgantown Fields, and that, if Transco chooses and elects to take and purchase gas produced from the said common pool and the wells producing therefrom, Transco shall ratably take from the wells producing from the common pool; and shall ratably take and purchase gas without discrimination in favor of one owner, operator or producer against another in the said common source of pool; and, specifically, in the event it so chooses and elects to take and purchase gas produced from the said common pool, Transco shall ratably take and purchase without discrimination in favor of the operators Getty and Tomlinson against Coastal, the Fairchilds, and Inexco.

Dated, this the 16th day of September, 1982.

STATE OIL & GAS BOARD OF MISSISSIPPI

By:_____
CHAIRMAN

STATE OF MISSISSIPPI
COUNTY OF HINDS

I hereby certify that the foregoing is a true and correct copy of Oil & Gas Board Order #409-82
now appearing on file and of record in the office of the State Oil and Gas Board at Jackson, Mississippi.
This the 13th day of October, 1982

A. Richard Henderson

A. RICHARD HENDERSON
Supervisor
State Oil & Gas Board

APPENDIX D

246

MINUTES, SUPREME COURT OF MISSISSIPPI
September Term, 1984

WEDNESDAY, OCTOBER 3, 1984
COURT SITTING

No. 55,071

TRANSCONTINENTAL GAS PIPE LINE CORP.

v.

THE STATE OIL & GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, *et al*

This cause this day came on to be heard on petition for rehearing filed herein and this Court having sufficiently examined and considered the same and being of the opinion that the same should be denied doth order that said petition be and the same is hereby Denied. Patterson, C. J., Bowling and Hawkins, JJ., not participating.

ATTEST
A True Copy
This the 8th day of Oct., 1984

ROBERT E. WOMACK
Clerk
SUPREME COURT OF MISSISSIPPI

By Yvonne Burnham, D.C.
Minute Book "BX", Page 246.

APPENDIX E

205

MINUTES, SUPREME COURT OF MISSISSIPPI
March Term, 1984

WEDNESDAY, SEPTEMBER 5, 1984
COURT SITTING

No. 55,071

TRANSCONTINENTAL GAS PIPE LINE CORP.
v.
THE STATE OIL & GAS BOARD OF MISSISSIPPI AND
COASTAL EXPLORATION, INC., *et al*

This cause having been submitted at a former day of this Term on the record herein from the Circuit Court of Hinds County and this Court having sufficiently examined and considered the same and being of the opinion that there is error therein doth order and adjudge that the judgment of said Circuit Court rendered in this cause on the 28th day of June, 1983, be and the same is hereby Affirmed in part, Reversed and Rendered in part and Remanded; all as fully set out in the opinion of this Court with directions. It is further ordered that the taxable costs before this court, before the Circuit Court and before the Board shall be; and they hereby are taxed one-half against Transco, as appellant, and one-half against appellees, jointly and severally for all of which let execution issue.

ATTEST
A True Copy
This the 8th day of Oct., 1984
ROBERT E. WOMACK
Clerk
SUPREME COURT OF MISSISSIPPI
By Yvonne Burnham, D.C.
Minute Book "BX", Page 205.

APPENDIX F

IN THE SUPREME COURT OF THE STATE OF MISSISSIPPI

No. 55,071

TRANSCONTINENTAL GAS PIPE LINE CORPORATION
Appellant,

VS.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., *et al.*,
Appellees.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Transcontinental Gas Pipe Line Corporation, appellant in the above styled cause, hereby appeals to the Supreme Court of the United States from the Order and Judgment of this Court, entered September 5, 1984, rehearing denied, October 3, 1984, which found that "Rule 48" and "Order No. 409-82" of the Mississippi State Oil and Gas Board were not repugnant to the Supremacy Clause, Commerce Clause, and Fourteenth Amendment of the Constitution of the United States.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

This 30th day of November, 1984.

TRANSCONTINENTAL GAS
PIPE LINE CORPORATION

By:_____
One of its Attorneys

Of Counsel:
JOHN M. GROWER
JEFFERSON D. STEWART
R. WILSON MONTJOY, II
BRUNINI, GRANTHAM, GROWER & HEWES
1400 First National Bank Building
Post Office Drawer 119
Jackson, Mississippi 39205
Telephone: (601) 948-3101

DAVID E. VARNER
RAY V. LOFTIN, JR.
DAVID A. GLENN
TRANSCONTINENTAL GAS PIPE LINE CORPORATION
Post Office Box 1396
Houston, Texas 77251
Telephone: (713) 439-2328

CERTIFICATE OF SERVICE

I, JEFFERSON D. STEWART, do hereby certify that I have this day mailed a true and correct copy of the above and foregoing Notice of Appeal to the following:

Hon. Lloyd Arnold
Office of the Attorney General
Gartin Justice Bldg.
Jackson, MS 39201
Attorney for Mississippi State Oil
and Gas Board

Hon. Glenn Gates Taylor
Heidelberg, Woodliff & Franks
Suite 1030 Capitol Towers
Jackson, MS 39201
Attorney for Coastal Exploration Inc.

Hon. Walker L. Waters
Gerald, Brand, Watters, Cox & Hemleben
400 Lamar Life Bldg.
Jackson, MS 39201
Attorney for Getty Oil Company

Hon. John Land McDavid
McDavid, Edmonson & Noblin
8th Floor, City Center North
210 S. Lamar Street
Jackson, MS 39201
Attorney for Inexco Oil Company

Hon. William L. Waller, Sr.
Waller & Waller
475 East Capitol Street
Jackson, MS 39201
Attorney for Fairchild Construction
Company

I further certify that I have also mailed a copy of the above Notice to Hon. Vernon L. Terrell, Jr., Plauche', Hartley, LaPeyre & Ottinger, Suite 3618 One Shell Square, New Orleans, LA 70139, Attorney for Tomlinson Interests, Inc.

THIS 30th day of November, 1984.

_____

Jefferson D. Stewart

APPENDIX G

FEDERAL CONSTITUTIONAL AND STATUTORY PROVISIONS

The Commerce Clause of the Constitution, U.S. Const. art. I, § 8, cl. 3:

> The Congress shall have power . . . to regulate commerce with foreign Nations, and among the several states, and with the Indian Tribes . . . .

The Supremacy Clause of the Constitution, U.S. Const. art VI, cl. 2:

> **SUPREME LAW OF LAND**
>
> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b):

> (b) The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation for sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

Section 107 of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3317:

CEILING PRICE FOR HIGH-COST NATURAL GAS

(a) **Wells completed below 15,000 feet.**—In the case of any first sale of high-cost natural gas produced from any well the surface drilling of which began on or after February 19, 1977, if such production is from any completion location which is located at a depth of more than 15,000 feet, the maximum lawful price under this section for such natural gas delivered during any month shall be the maximum lawful price, per million Btu's, computed for such month under section 3312 of this title (relating to new natural gas).

(b) **Commission authority to prescribe higher incentive prices.**—The Commission may, by rule or order, prescribe a maximum lawful price, applicable to any first sale of any high-cost natural gas, which exceeds the otherwise applicable maximum lawful price to the extent that such special price is necessary to provide reasonable incentives for the production of such high-cost natural gas.

(c) **Definition of high-cost natural gas.**—For purposes of this section, the term "high-cost natural gas" means natural gas determined in accordance with section 3413 of this title to be—

(1) produced from any well the surface drilling of which began on or after February 19, 1977, if such production is from a completion location which is located at a depth of more than 15,000 feet;

(2) produced from geopressured brine:

(3) occluded natural gas produced from coal seams;

(4) produced from Devonian shale; and

(5) produced under such other conditions as the Commission determines to present extraordinary risks or costs.

(d) **Provisions for high-cost natural gas to be elective.**—If any credit, exemption, deduction, or comparable adjustment applicable to the computation of any Federal tax is specifically allowable with respect to any high-cost natural gas (or category thereof) under any provision of law enacted after November 9, 1978, the provisions of subsections (a) and (b) of this section and the provisions of part B of this subchapter shall not apply to such natural gas produced from any well unless an election to have such provisions apply (in lieu of such credit, exemption, deduction, or adjustment) with respect to such natural gas produced from such well is filed with the Commission on or before the later of—

(A) the 30th day after November 9, 1978, under which such credit, exemption, deduction, or adjustment is provided; or

(B) the date the surface drilling of such well began.

Section 121 of the NGPA, 15 U.S.C. § 3331:

ELIMINATION OF PRICE CONTROLS FOR CERTAIN NATURAL GAS SALES

(a) **General rule.**—Subject to the reimposition of price controls as provided in section 3332 of this title, the provisions of part A of this subchapter respecting the maximum lawful price for the first sale of each of the following categories of natural gas shall, except as provided in subsections (d) and (e) of this section, cease to apply effective January 1, 1985:

(1) **New natural gas.**—New natural gas (as defined in section 3312(c) of this title).

(2) **New, onshore production wells.**—Natural gas produced from any new, onshore production well (as

defined in section 3313(c) of this title), if such natural gas—

(A) was not committed or dedicated to interstate commerce on April 20, 1977; and

(B) is produced from a completion location which is located at a depth of more than 5,000 feet.

(3) **Intrastate contracts in excess of $1.00.**—Natural gas sold under an existing contract, any successor to an existing contract, or any rollover contract, if—

(A) such natural gas was not committed or dedicated to interstate commerce on November 8, 1978; and

(B) the price paid for the last deliveries of such natural gas occurring on December 31, 1984, or, if no deliveries occurred on such date is higher than $1.00 per million Btu's.

(b) **High-cost natural gas.**—Effective beginning on the effective date of the incremental pricing rule required under section 3341 of this title, the provisions of part A of this subchapter respecting the maximum lawful price for the first sale of natural gas shall cease to apply to the first sale of high-cost natural gas which is described in section 3317(c) (1), (2), (3), or (4) of this title.

(c) **Natural gas produced from 5,000 or less.**—Effective beginning July 1, 1987, or, if later, the date of expiration of any price controls reimposed under section 3332 of this title, the provisions of part A of this subchapter respecting the maximum lawful price for any first sale of natural gas shall, except as provided in subsection (d) of this section, cease to apply to any first sale of natural gas produced from any new, onshore production well (as defined in section 3313(c) of this title), if such natural gas—

(1) was not committed or dedicated to interstate commerce on April 20, 1977; and

(2) is produced from a completion location which is located which is located at a depth of 5,000 feet or less.

(d) **Exclusion of certain Alaska natural gas.**—The provisions of subsections (a) and (c) of this section shall not apply to any natural gas produced from the Prudhoe Bay Unit of Alaska and transported through the natural gas transportation system approved under the Alaska Natural Gas Transportation Act of 1976.

(e) **Limitation on indefinite price excalators.**—Natural gas which is not subject to maximum lawful prices under part A of this subchapter solely by reason of subsection (a) (3) of this section and which is sold under any existing contract or successor to an existing contract at a price established under an indefinite price escalator clause (as defined in section 3315(b) (3) (B) of this title) shall be subject to the provisions of section 3315(b) (3) of this title.

Section 601 of the NGPA, 15 U.S.C. § 3431:

COORDINATION WITH NATURAL GAS ACT

(a) **Jurisdiction of Commission under Natural Gas Act.—**

(1) **Sales.—**

(A) **Natural gas not committed or dedicated.—** For purposes of section 1(b) of the Natural Gas Act, effective on the first day of the first month beginning after November 9, 1978, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply to natural gas which was not committed or dedicated to interstate commerce as of November 8, 1978, solely by reason of any first sale of such natural gas.

(B) **Committed or dedicated natural gas.—** Effective beginning on the first day of the first month

beginning after November 9, 1978, for purposes of section 1(b) of the Natural Gas Act, the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of November 8, 1978, and which is—

(i) high-cost natural gas (as defined in section 3317(c) (1), (2), (3), or (4) of this title);

(ii) new natural gas (as defined in section 3312(c) of this title); or

(iii) natural gas produced from any new, onshore production well (as defined in section 3313(c) of this title).

(C) **Authorized sales or assignments.**—For purposes of section 1 (b) of the Natural Gas Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply by reason of any sale of natural gas—

(i) authorized under section 3362(a) or 3371(b) of this title; or

(ii) pursuant to any assigned authorized under section 3371(a) of this title.

(D) **Natural-gas company.**—For purposes of the Natural Gas Act, the term "natural-gas company" (as defined in section 2(6) of such Act) shall not include any person by reason of, or with respect to, any sale of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission do not apply to such sale solely by reason of subparagraph (A), (B), or (C) of this paragraph.

(E) **Alaskan natural gas.**—Subparagraph (B) (ii) and (iii) shall not apply with respect to natural gas produced from the Prudhoe Bay unit of Alaska and

transported through the transportation system approved under the Alaska Natural Gas Transportation Act of 1976.

(2) **Transportation.—**

(A) **Jurisdiction of the Commission.** For purposes of section 1(b) of the Natural Gas Act the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply to any transportation in interstate commerce of natural gas if such transportation is—

(i) pursuant to any order under section 3362(c) or section 3363(b), (c), (d), or (h) of this title; or

(ii) authorized by the Commission under section 3371(a) of this title.

(B) **Natural-gas company.** For purposes of the Natural Gas Act, the term "natural-gas company" (as defined in section 2(6) of such Act) shall not include any person by reason of, or with respect to, any transportation of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission under the Natural Gas Act do not apply to such transportation by reason of subparagraph (A) of this paragraph.

(b) **Charges deemed just and reasonable.**

(1) **Sales.**

(A) **First sales.** Subject to paragraph (4), for purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any first sale of natural gas shall be deemed to be just and reasonable if—

(i) such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter; or

(ii) there is no applicable maximum lawful price solely by reason of the elimination of price controls pursuant to part B of subchapter I of this chapter.

(B) **Emergency sales.** For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any sale authorized under section 3361(a) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established under such section and applicable to such sale.

(C) **Sales by intrastate pipelines.** For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any sale authorized by the Commission under section 3371(b) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established by the Commission and applicable to such sale.

(D) **Assignments.** For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid pursuant to the terms of any contract with respect to that portion of which the Commission was authorized an assignment authorized under section 3372(a) of this title shall be deemed to be just and reasonable if such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter.

(E) **Affiliated entities limitation.** For purposes of paragraph (a), in the case of any first sale between any interstate pipeline and any affiliate of such pipeline, any amount paid in any first sale shall be deemed to be just and reasonable if, in addition to satisfying the requirements of such paragraph, such amount does not exceed the amount paid in comparable first sales between persons not affiliated with such interstate pipeline.

(2) **Other charges.—**

(A) **Allocation.**—For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid by any interstate pipeline for transportation, storage, delivery or other services provided pursuant to any order under section 3363(b), (c), or (d) of this title shall be deemed to be just and reasonable if such amount is prescribed by the President under Section 3363(h)(1) of this title.

(B) **Transportation.**—For purposes of sections 4 and 5 of the Natural Gas Act, any amount paid by any interstate pipeline for any transportation authorized by the Commission under section 3371(a) of this title shall be deemed to be just and reasonable if such amount does not exceed that approved by the Commission under such section.

(c) **Guaranteed passthrough.—**

(1) **Certificate may not be denied based upon price.**—The Commission may not deny, or condition the grant of, any certificate under section 7 of the Natural Gas Act based upon the amount paid in any sale of natural gas, if such amount is deemed to be just and reasonable under subsection (b) of this section.

(2) **Recovery of just and reasonable prices paid.**—For purposes of sections 4 and 5 of the Natural Gas Act, the Commission may not deny any interstate pipeline recovery of any amount paid with respect to any purchase of natural gas if—

(A) under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4 and 5 of such Act, and

(B) such recovery is not inconsistent with any requirement of any rule under section 3341 of this title

(including any amendment under section 3342 of this title),

except to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds.

Section 602 of the NGPA, 15 U.S.C. § 3432:

EFFECT ON STATE LAWS

(a) **Authority to prescribe lower maximum lawful prices.**—Nothing in this chapter shall affect the authority of any State to establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the applicable maximum lawful price, if any, under subchapter I of this chapter.

(b) **Common carriers.**—No person shall be subject to regulation as a common carrier under any provision of Federal or State law by reason of any transportation—

(1) pursuant to any order under section 3362(c) or section 3363(b), (c), (d), or (i) of this title; or

(2) authorized by the Commission under section 3371(a) of this title.

STATE STATUTES AND REGULATIONS

Miss. Code Ann. § 53-1-1 (1972):

DECLARATION OF POLICY.

It is hereby declared to be in the public interests to foster, encourage and promote the development, production and utilization of the natural resources of oil and gas in the State of Mississippi; and to protect the public and private interests against the evils of waste in the production and utilization of oil and gas, by prohibiting waste as herein defined; to safeguard, protect and enforce the coequal and correlative rights of owners in a common source

or pool of oil and gas to the end that each such owner in a common pool or source of supply of oil and gas may obtain his just and equitable share of production therefrom; and to obtain, as soon as practicable, consistent with the prohibition of waste, the full development by progressive drilling of other wells in all producing pools of oil and gas or of all pools which may hereafter be brought into production of such, within the state, until such pool is fully defined.

It is not the intent nor the purpose of this law to require or permit the proration or distribution of the production of oil and gas among the fields and pools of Mississippi, on the basis of market demand. It is the intent and purpose of this law to permit each and every oil and gas pool in Mississippi to be produced up to its maximum efficient rate of production, subject to the prohibition of waste as herein defined, and subject further to the enforcement and protection of the co-equal and correlative rights of the owners of a common source of oil and gas, so that each common owner may obtain his just and equitable share of production therefrom.

Statewide Rule 48 of the Mississippi State Oil and Gas Board:

RATABLE TAKE

Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, of producers shall purchase without discrimination in favor of one owner, operator, or producer against another in the same common source of supply.

APPENDIX H

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

IN RE: WHETHER the AUTHORITY to REQUIRE RATABLE TAKE of NATURAL GAS by FIRST PURCHASERS who are INTERSTATE PIPELINES.

Gen. Cause No. 28770

NOTICE OF INQUIRY
AND
MOTION TO CONSOLIDATE CAUSES

STATE OF OKLAHOMA TO: All persons, owners, producers, operators, purchasers and takers of oil and gas, and all other interested persons in the State of Oklahoma.

Several causes pending before the Oklahoma Corporation Commission concern the Commission's right to exercise jurisdiction over purchases by interstate pipelines which purchase natural gas produced in Oklahoma.

COMES NOW M. Keywood Deese, Deputy General Counsel for Conservation for the Oil and Gas Conservation Division of the Oklahoma Corporation Commission, and moves to consolidate all causes currently filed and pending on or before the date this motion is acted upon, which concern the Corporation Commission's jurisdiction with respect to ratable takes, pursuant to the Oklahoma Statutes and the Corporation Commission rules and regulations, by first purchasers which are interstate pipelines.

The pending causes involve the following issues:

(1) Is the State of Oklahoma preempted by the Commerce Clause of the United States Constitution from enforcing the requirements of 52 O.S. § 240, relating to the ratable taking of gas, against first purchases by interstate pipelines of Oklahoma-produced natural gas.

(2) Does the Federal Energy Regulatory Commission under the Natural Gas Act of 1938 and Natural Gas Policy Act of 1978 have sole authority over the regulation of gas purchases by interstate purchasers of natural gas thereby preempting the State of Oklahoma from acting under 52 O.S. 1981, Sections 239 and 240?

(3) Do interstate pipelines, when making first purchases of natural gas produced in Oklahoma, have to comply with Rule 1-305, a *Priority Schedule for Supply and Demand Imbalance*, adopted in Order No. 246797 issued on October 19, 1983?

Inasmuch as many pending causes involving these common issues of law, and in order to assure as wide an opportunity to participate as possible in the Commission's ultimate determination of those common issues, the Oil and Gas Conservation Division recommends that all currently pending causes that have contained in them the above-stated issues be consolidated into one proceeding and that proceeding be phased into two parts. The first phase would be a Commission decision, following briefing and oral argument by all interested parties, on the above-stated issues of law common to all causes. In the second phase, the cases would be separated for any further necessary proceedings on an individual basis.

In more specificity, it is moved:

(1) That all parties who have filed Causes involving the above questions of law continue said Causes to the 1st day of April, 1984.

(2) That additional cases filed involving these questions be also set on the 1st day of April, 1984.

(3) That the Commission consolidate all such causes and establish an initial thirty (30) day briefing period and a fifteen (15) day reply briefing schedule to be followed by oral argument to a panel of three hearing officers to be designated by the Chief Hearing Officer. The panel would issue a report to which exceptions could be taken in oral and written manner before the Commission.

The staff makes this motion in an effort to seek resolution of this singularly important question of law through a procedure that is at once both administratively efficient and open to participation by all potentially affected and otherwise interested parties. The Commission decision reached herein will be dispositive of these questions before the Commission respecting the consolidated causes and serve as precedential value in future causes of this nature.

All parties wishing to be heard on this motion should appear before the Commission on the 22 day of February, 1984, at 9:00 a.m. in Courtroom 301.

For information concerning this Notice and Motion, contact M. Keywood Deese, Deputy General Counsel for Conservation, Room 460, Oklahoma Corporation Commission, Jim Thorpe Building, Oklahoma City, Oklahoma 73105, Telephone (405) 521-2255.

Respectfully submitted,

M. Keywood Deese
Deputy General Counsel
For Conservation

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

IN RE: WHETHER THE OKLAHOMA CORPORATION COMMISSION HAS THE AUTHORITY TO REQUIRE RATABLE TAKE OF NATURAL GAS BY FIRST PURCHASERS WHO ARE INTERSTATE PIPELINES.

Gen. Cause No. 28770
Order No. 254451

ORDER CONSOLIDATING CAUSES

On February 22, 1984, a Notice of Inquiry and Motion to Consolidate Causes came on for hearing before the Oklahoma Corporation Commission sitting en banc. The Notice and Motion were filed by M. Keywood Deese, Deputy General Counsel for Conservation; appearing for the Oil and Gas Conservation Division. Other appearing parties are listed in the Secretary's official record in this cause.

FINDINGS AND ORDER

1. The Deputy General Counsel for Conservation moved to consolidate several pending causes which concern the Commission's jurisdiction with respect to ratable takes, pursuant to the Oklahoma Statutes and the Corporation Commission rules and regulations, by first purchasers which are interstate pipelines.

2. The Commission finds that inasmuch as these causes involve common issues of law and in order to assure as wide an opportunity to participate as possible in the Commission's ultimate determination of those common issues, that these causes shall be consolidated into one proceeding which will be divided into two phases. The first phase will involve a Commission

determination as to jurisdiction after a review of a Report from the Hearing Officers and in the second phase, all cases will be separated and continued for any further necessary proceedings on an individual basis before a Trial Examiner.

3. The Commission hereby finds that issue number three included in the Notice of Inquiry is not necessary to a determination of the jurisdiction of the Commission. The Commission further finds that the request of Cities Service Oil and Gas Corp. to add an additional question relating to question number three is therefore unnecessary.

4. The Commission finds that the two issues which shall be reviewed on a consolidated basis from the pending causes are:

(1) Is the State of Oklahoma preempted by the Commerce Clause of the United States Constitution from enforcing the requirements of 52 O.S. 1981, § 240, relating to the ratable taking of gas, against first purchases by interstate pipelines of Oklahoma-produced natural gas?

(2) Does the Federal Energy Regulatory Commission under the Natural Gas Act of 1938 and Natural Gas Policy Act of 1978 have sole authority over the regulation of gas purchases by interstate purchasers of natural gas thereby preempting the State of Oklahoma from acting under 52 O.S. 1981, § § 239 and 240?

5. The procedures to be followed during phase one of these proceedings are as follows:

(1) All currently pending causes and any additional causes filed involving the above enumerated issues shall be continued or set for hearing on or after July 2, 1984.

(2) By March 16, 1984, any interested party in these proceedings shall file an *original* and *one copy of a Notice of Appearance* in the Secretary's office, including a current mailing address for all pleadings and notices. The Commission requests, but does not hereby order, that all parties filing the Notice of Appearance

include thereon an election as to alignment on the issue of the Commission's jurisdiction in these cases.

(3) That all interested parties may file a brief in this cause dealing with the above issues by March 30, 1984.

(4) That reply briefs shall be filed by May 1, 1984.

(5) All briefs filed according to (3) and (4) above shall be mailed by the filing party to all other parties who have filed a Notice of Appearance. The Secretary of the Commission shall maintain the official mailing list.

(6) That the Chief Hearing Officer shall appoint three Hearing Officers to hear oral argument of the parties on May 21, 1984, at 10:00 a.m. in Courtroom 301. These Hearing Officers shall review the briefs and arguments and issue a Report which if appealed, said appeal shall be heard by the Commission en banc.

6. It is ordered that this Order be published and notice sent as required by law and the Rules of the Commission.

7. The Commission further orders that any final order issued by the Commission in these proceedings shall be a determination of the jurisdictional issues presented in the individual cases consolidated and of precedential value in future causes filed regarding these issues.

DONE AND PERFORMED the 27 day of February, 1984.

CORPORATION COMMISSION OF OKLAHOMA

_____

Hamp Baker Chairman

_____

Norma Eagleton, Vice-Chairman

_____

James B. Townsend, Commissioner

ATTEST:

_____

Berdee S. Holt, Secretary

APPENDIX I

TITLE 16. ECONOMIC REGULATION

Part I. Railroad Commission of Texas
Chapter 3. Oil and Gas Division
Conservation Rules and Regulations

---

16 TAC §§ 3.28, 3.30, 3.31

(Editor's note: The text of the following rules proposed for repeal will not be published. The rules may be examined in the offices of the Railroad Commission of Texas, 1124 IH 35 South, Austin, or in the Texas Register office, Room 503E, Sam Houston Building, 201 East 14 Street, Austin.)

The Railroad Commission of Texas proposes the repeal of §§ 3.28, 3.30, and 3.31, concerning gas well potentials, gas nominations, and gas well allowables. The repeal will allow adoption of new versions of the rules.

Patrick Thompson, Oil and Gas Division legal examiner, has determined that for the first five-year period the repeal will be in effect there will be no fiscal implications for state or local government or small businesses as a result of the repeal.

Mr. Thompson also has determined that for each year of the first five years the repeal as proposed is in effect the public benefit anticipated as a result of the repeal is accommodation for the adoption of new sections. The merits of the new sections are discussed.

The Railroad Commission of Texas proposes new §§ 3.28, 3.30, and 3.31, concerning gas well potentials, gas nominations, and gas well allowables, respectively. The proposed new sections are designed to provide for more fair and accurate regulation of gas production and allocation.

Patrick Thompson, Oil and Gas Division legal examiner, has determined that for the first five-year period the rules will be in effect there will be no fiscal implications for state or local government or small businesses as a result of enforcing or administering the rules.

Mr. Thompson also has determined that for each year of the first five years the rules as proposed are in effect the public benefit anticipated as a result of enforcing the rules as proposed is increased understanding of the new sections, more fair and accurate gas proration through more accurate and reliable deliverability tests and more fair nominations, and improved conservation through changes in priority for gas production. The anticipated economic cost to individuals who are required to comply with the rules as proposed will not vary from those under the rules simultaneously proposed for repeal.

Comments on the proposed new sections may be submitted to Patrick Thompson, Legal Section, Oil and Gas Division, Railroad Commission of Texas, P.O. Drawer 12967, Austin, Texas 78711.

[9 TexReg 4808, September 11, 1984]

The new sections are proposed under the Texas Natural Resources Code, §§ 86.041, 86.042, and 86.081, which provides the Railroad Commission of Texas with the authority to prorate and regulate the production of natural gas to prevent waste and adjust the correlative rights and opportunities of owners of gas to use or sell their gas.

§ 3.28 *Deliverability of Gas Wells to Be Ascertained and Reported.*

(a) The absolute daily open flow potential of each producing associated or nonassociated gas well shall be ascertained and a report shall be filed in duplicate in the appropriate district office within 30 days of the completion of the well. The absolute daily open flow potential shall be determined in accordance with the instructions contained in the commission's publication, *Back Pressure Test for Natural Gas Wells, State of Texas,*

and shall be reported on the commission's prescribed form. Any backdating of allowables will be performed in accordance with § 3.31 of this title (relating to Gas Well Allowables).

(b) After conducting the test required by subsection (a) of this section, each operator of a gas well shall conduct an initial deliverability test not later than 10 days after the state of production for one or more legal purposes and shall report such initial deliverability on the prescribed form. After the original deliverability tests have been conducted, each operator of a gas well shall conduct a deliverability test semiannually, unless otherwise provided by the applicable field rules. All deliverability tests shall be conducted in accordance with subsection (c) of this section and the instructions printed on the Form G-10. The results of each test shall be attested to by the operator or his appointed agent and by a designated representative of the purchaser, in the place provided on the Form G-10. Gas meter charts, printouts, or other documents showing the actual measurement of the gas produced during any deliverability test conducted under this section shall be preserved by the maker for a period of no less than two years after the performance of the test and shall be furnished to the Railroad Commission of Texas, operator, or purchaser upon request. In the event that the purchaser refuses to sign the G-10 form and both parties cannot agree upon the validity of the test results, then either party may request a retest of the well. The retest will be witnessed by a representative of the commission and will be scheduled within seven working days of the request, if possible. The results of a commission-witnessed test shall be conclusive for the purposes of this section until the next regularly scheduled test of the well. In the event a retest is performed by the commission, the retest shall be signed by the representative of the commission. In the event that downhole remedial work or a compressor, pumping unit, or other substantial production enhancement work has been performed on any well subject to the testing procedure described in this subsection, then a new test may be requested and shall be

performed according to the procedure outlined in this subsection.

(c) Unless the director of the Oil and Gas Division or his delegate grants an exception due to limited production capacity, all deliverability tests shall be performed by producing the subject well for a minimum time period of 72 hours. The average daily producing rate for each 24-hour period, the wellhead pressure before the commencement of the 72-hour test, and flowing wellhead pressure at the beginning of each 24-hour period shall be recorded and reported as required on the Form G-10. In addition, a 24-hour shut in the wellhead pressure shall be recorded on the Form G-10 either before or after the flow test. The flow rate during the first 48 hours of the test must be as close as possible to the flow rate during the final 24 hours of the test, but must equal at least 75% of such flow rate. The deliverability of the well during the last 24 hours of the flow test shall be used for allowable and allocation purposes. Deliverability tests shall be scheduled by either the producer or purchaser with the concurrence of the other and within the testing period designated by the Railroad Commission of Texas. A deliverability test shall be conducted under normal and usual operating conditions using the normal and usual operating equipment in place on the well being tested, and produced against the normal and usual line pressure prevailing in the line into which the well produces.

(d) First purchasers with packages of gas dedicated entirely to a downstream purchaser shall coordinate testing with and provide test results to that downstream purchaser if requested by the downstream purchaser. In such cases, the downstream purchaser shall have the right to witness all deliverability tests and retests.

(e) The appropriate district office shall be notified at least 24 hours prior to any back pressure, production, or shut-in test. Tests of wells connected to a pipeline shall be made in such manner that no gas is flared.

§ 3.30. *Gas Nominations Required.*

(a) All first purchasers of gas produced from wells shall file by the ninth day of each month nominations of requirements for gas to be used by them from each reservoir during the following month. Purchasers who gather gas from various gas fields and reservoirs or who purchase gas at the wellhead of the wells or purchase gas at a common purchase point must determine if they are the initial purchaser and, if so, shall file gas nominations. An operator using 100% of the gas from a gas well for his own operations, either on leases or in a fuel system, shall file gas nominations. An operator using a portion of the gas produced from a well must notify the nominator of the volume or percentage of total volume required, including lease separation extraction or percentage loss. The initial nominator must include that amount in its nominations. After initial notification, the operator need only inform the nominator of changes in the volume or percentage of total volume required. Operators of processing plants who operate field gathering systems and who are the purchasers of gas at the wellhead shall file gas nominations.

(b) The first purchaser shall act as initial nominator. By the fourth day of each month, each initial nominator shall inform its producers of the amount it intends to nominate from each producer. Each initial nominator shall nominate for a total quantity of gas equal to the sum of:

(1) the quantity for which the operator or the initial nominator are the ultimate consumers. This amount will include lease shrinkage, line loss, plant fuel, compressor use, as well as the gas which the initial purchaser may consume at the point of final delivery; and

(2) The total quantity of gas nominated by its downstream purchasers in accordance with the following provisions:

[9 TexReg 4809, September 11, 1984]

(A) all downstream purchasers who take more than 10 MMcf per day shall submit monthly to their initial or first

nominators of gas a downstream purchaser's nomination based on a firm forecast of that purchaser's actual demand;

(B) if a downstream purchaser takes gas from more than one source of supply, that downstream purchaser's nomination shall show expected demand from each source;

(C) written monthly nominations from downstream purchasers shall be kept on file by the initial nominator for commission inspection and shall be filed with the commission on its request;

(3) the remaining quantity of gas which the initial nominator expects to take for direct sale to end-users and any other volumes for which no nomination has been made under paragraph (1) or paragraph (2) of this subsection.

(c) Nominations by a purchaser for a field may not exceed the deliverability to that nominator from that field. The initial nominator of gas shall ratably apportion its nominations among the various fields on a system from which it purchases gas without unjust or unreasonable discrimination. The nomination for each field shall be a consistent percentage of the total deliverability available to the nominator from each field. The nominator shall include the following on the nomination form:

(1) the nomination as a volume of gas in MCF;

(2) the nomination as a percentage of the total deliverability of wells connected to the nominator's system in each field;

(3) the nomination which the nominator filed for that field for the second preceding month (including revisions which were properly filed);

(4) the volume of gas (in MCF) actually taken by the nominator from that field during the second preceding month.

(d) First priority in the nominations for the purchase of gas shall be given to casinghead gas so that gas produced in association with oil production shall not be wastefully vented and oil

production shall not be unnecessarily curtailed. Second priority shall be given to special allowable gas. Third priority shall be given to Statewide Rule 49(b) gas. Refer to § 3.34 of this title (relating to Gas to Be Taken Ratably) for instructions on priority of takes for various categories of gas.

§ 3.31. *Gas Well Allowables.*

(a) General. Allowables of gas wells not currently assigned an allowable will not be made effective:

(1) prior to the well's completion or reclassification date; or

(2) more than 15 days prior to the date all reports or information necessary to the assignment of an allowable are received in the proper commission office. If any report or item of information necessary to the assignment of an allowable is not filed on time, there shall be a one-day allowable reduction for each day the report or information is late.

(b) Changes in gas well allowables.

(1) Changes in allowables of gas wells currently assigned an allowable will be effective on the date of the test or date of the change affecting the well's allowable (when the operator submits special tests or information), provided this is not more than 15 days prior to the date the special test or information is received in the appropriate district office.

(2) With respect to a multicompleted well, the allowable of the second and succeeding zones will be made effective as of the date the multicompletion is approved by the commission or as of the date the last report or item necessary to the assignment of an allowable is received in the commission's office, whichever is the later of the two dates.

(3) When a well is recompleted as a gas well in a different reservoir, any overproduction that has occurred in the old reservoir must be made up before an allowable will be assigned in the new reservoir.

(c) Requirements for gas wells in a field for which an allocation formula has been adopted. In addition to the general requirements set out in subsection (a) and subsection (b) of this section, the following requirements must be met where an allocation formula is applicable before an allowable will be assigned.

(1) If acreage is a factor in the allocation formula, a certified plat showing the acreage to be assigned to the well for proration purposes must be submitted. The plat must be accompanied by a statement that all of the acreage claimed can reasonably be considered productive of gas in that reservoir, and that the distance limitations of the field rules have not been exceeded. If all of the acreage claimed is not contained in a single lease, a certificate of pooling authority must be submitted, stating that the acreage has been pooled. If the distance limitations of the field rules are shown to have been exceeded, the plat must show the number of acres within and beyond the distance limitations. If all of the acreage cannot be considered productive, the plat must also show the productive limit of the acreage. If a plat shows acreage in the proration unit in excess of the maximum number of acres permitted by the field rules, it will not be accepted. The commission shall also be advised if an exception to the distance limitations is desired.

(2) If bottom-hole or reservoir pressure is a factor in the allocation formula, it must be submitted on the appropriate form and must be measured at, or corrected to, the proper datum plane.

(d) Ascertaining allowables by adjustment of gas nominations.

(1) The allocation of allowables to all wells in prorated gas reservoirs will be determined from the nominations submitted, and after consideration at statewide hearing. However, in order to ascertain the reasonable market demand for the gas, nominations for gas shall be adjusted by comparing the latest reported production from the field to the nominaitons filed for that period by purchasers from the field.

(2) The total nominations for gas from prorated wells for any month shall be determined by subtracting the total allowable assigned to nonprorated wells during the months from the total nominations for gas from all wells in the reservoir for that month.

(3) Nothing in this subsection shall be interpreted, however, as binding on the commission to the extent that any adjustment of nominations cannot be made which is necessary to adjust the allowables for gas to an amount equal to market demand as is required of the commission by the statutes.

[9 TexReg 4810, September 11, 1984]

(e) Allowables for prorated and nonprorated wells.

(1) Prorated wells. A prorated well is a well whose allowable is determined by the field allocation formula.

(2) Nonprorated wells. A nonprorated well is a well whose allowable is not determined by the field allocation formula and includes the following types of wells.

(A) A limited well is a well incapable of producing the allowable it would receive under the allocation formula. A limited well shall be assigned an allowable at the rate that the well is capable of producing.

(B) A special allowable well is a well that has been granted a fixed allowable pursuant to commission action. Gas from special allowable wells has priority over prorated gas. A well is classified as a special allowable well based on evidence that producing the well below a specified level will cause loss of the well or loss of recoverable gas.

(3) Allowable adjustments and balancing provisions for limited wells.

(A) A limited well shall not be allowed to accumulate underproduction.

(B) If the most recent production figures reported to the commission show a limited well to be overproduced, the

allowables will be revised to an amount attributable to it under the field allocation formula. If a well's capability to produce, plus its latest overproduction, is less than its formula allowable, it will be assigned its ability to produce, plus its latest overproduction.

(C) If a limited well is assigned an allowable that results in its removal from the nonprorated classification, the underage status of the well shall be reinstated in the amount discontinued at the time the well was placed in the nonprorated category. However, credit will not be given for underproduction attributable to those months when the well was in a nonprorated category, nor can credit be given to underproduction that accumulated prior to the immediately preceding balancing period.

(f) Balancing provisions for overproduction and underproduction of gas for wells completed in nonassociated gas reservoirs. For the purpose of computing and balancing overproduction and underproduction in a gas field in which distribution of allowables to the several wells completed in a common reservoir is governed by special operating rules, the dates 7 a.m., March 1, and 7 a.m., September 1, are to be known as "balancing dates"; and the six months' periods beginning 7 a.m., March 1, and ending 7 a.m., September 1, and beginning 7 a.m., September 1, and ending 7 a.m., March 1, will be considered as separate entities and will be known as "balancing periods."

(1) Underproduction.

(A) If a prorated gas well during the balancing period does not produce as much gas as is allocated to it by the order of the commission, the operator of the well shall be permitted to carry such underproduction forward to the next succeeding balancing period, as future allowable credit to be produced during that period.

(B) The amount of underproduction to be carried forward into any new balancing period as allowed production

during such new balancing period shall consist of the actual underproduction that accrued in the balancing period immediately preceding such new balancing period, and the accumulative well status, as to underproduction, will be adjusted on each balancing date accordingly. Underproduction which accrued prior to the previous balancing period will be canceled. Applications to carry forward underproduction accrued prior to the previous balancing period may be filed with the director of technical hearings. Such applications will be granted only pursuant to hearing with notice to all operators in the field.

(C) Underproduction applicable to any well shall not be made up at a rate in excess of twice the daily average rate required to produce the normal monthly allowable of the well. Under emergency conditions, exceptions to this provision may be granted by the director of the Oil and Gas Division or his delegate.

(D) If a producing well has been accumulatively underproduced on each of two successive balancing dates, the well shall not be assigned a monthly allowable greater than the maximum monthly production from the well during the immediately preceding balancing period; provided, however, the limited allowable assigned to the well may be adjusted to a value not to exceed the allowable applicable to the well under the allocation formula, upon certification to the commission from the operator that such well is producing gas in excess of the limited allowable assigned it.

(2) Overproduction.

(A) Each operator of each gas well, subject to the hereinafter prescribed conditions, may produce the well in excess of the monthly allowable allocated to the well; provided that no well shall in any one month produce in excess of twice the current monthly allowable of the well. Exceptions to this limit may be granted by the commission upon application. No more than two exceptions may be given to a well during one balancing period.

(B) Except where a well is shut-in to make up overproduction (see subparagraph (C) and subparagraph (D) of this paragraph), overproduction existent as of any balancing date shall be made up during the balancing period immediately following, and may be made up at any time during such period.

(C) Any well overproduced as of a balancing date, which was also overproduced on the balancing date immediately preceding and remained overproduced for the entire period between the two balancing dates, shall be shut in until the overproduction, existent as of the later of such two balancing dates, is made up, unless exception is granted as provided for in subparagraph (D) of this paragraph.

(D) The operator of a well which, under the provisions of subparagraph (C) of this paragraph, would be required to be shut in, may request authority to produce the well at a reduced rate. Authority to produce at a reduced rate until the end of the balancing period may be granted administratively by the director of proration if no protest is received from other operators in the field. If a protest is received, reduced rate authority may be granted only pursuant to hearing. Notice of the hearing will be given to all operators in the field. If, after consideration of the evidence submitted at the hearing, the commission finds that the well would be damaged if shut in, the commission may allow the overproduction charged against it to be made up at a lesser rate than it would be made up if the well were shut in. Production of the [9 TexReg 4811, September 11, 1984] well in any one month may not exceed half the normal rate.

This agency hereby certifies that the proposal has been reviewed by legal counsel and found to be within the agency's authority to adopt.

Issued in Austin, Texas, on August 28, 1984.

TRD-849090 Walter Earl Lilie
Special Counsel
Railroad Commission of Texas

Proposed date of adoption:

November 5, 1984
For further information, please call (512) 445-1186.

16 TAC § 3.34

The Railroad Commission of Texas proposes new § 3.34, concerning ratable taking of natural gas.

The new section, if adopted, will replace § 3.91, which is simultaneously proposed for repeal. The proposed new section alters the commission's regulation of ratable taking to make it responsive to changes in the gas industry.

Patrick Thompson, Oil and Gas Division legal examiner, has determined that for the first five-year period the rule will be in effect there will be no fiscal implications for state or local government or small businesses as a result of enforcing or administering the rule.

Mr. Thompson also has determined that for each year of the first five years the rule as proposed is in effect the public benefit anticipated as a result of enforcing the rule as proposed is increased understanding of the rule, greater flexibility in the purchasing and transporting of natural gas, and increased accessibility of gas and transportation facilities. The anticipated economic cost to individuals who are required to comply with the rule as proposed will not vary from that under the rule currently proposed for repeal.

Comments on the proposal may be submitted to Patrick Thompson, Legal Section, Oil and Gas Division, Railroad Commission of Texas, P.O. Drawer 12967, Austin, Texas 78711.

A public hearing on the proposed new section is scheduled in Room 221, Railroad Commission of Texas Building, 1124 IH 35 South, Austin, at 9 a.m. on Monday, October 22, 1984. Written comments will be accepted through October 23, 1984.

The new section is proposed under the Texas Natural Resources Code, § 111.083 and § 111.090, which provides the Railroad Commission of Texas with the authority to adopt rules to prevent discriminatory purchasing or taking of natural gas.

§ 3.34. *Gas to be Taken Ratably.*

(a) This rule is promulgated to promote and maintain ratable production of natural gas and to protect correlative rights through the enforcement of ratable taking by natural gas pipelines. Enforcement of this rule is also intended to prevent the exercise of monopoly power by natural gas pipelines. A purchaser or transporter of gas from gas wells may not discriminate between different wells in the same field, nor may it discriminate unjustly or unreasonably between wells in separate fields. The provisions of this rule requiring ratable taking of gas apply to takes from all gas wells on a pipeline system, excluding Statewide Rule 49(B) wells and special allowable wells. The taking of casinghead gas is also excluded. Subsection (g) of this section governs takes from the excluded wells.

(b) Purchasers of natural gas, including pipelines and their subsidiaries or affiliates, which purchase gas from different wells in the same field shall purchase the same percentage of allowable from all such wells in the field which offer their gas for purchase. Purchases from limited wells shall be in accordance with subsection (e) of this section. When purchasing from split stream wells, this percentage should be applied to that portion of the total allowable dedicated to the particular purchaser on the commission Form P-4, and not to the total allowable for the well. If takes from different wells in the same field become nonratable, the purchaser shall take commission-assigned underproduction and overproduction into consideration in establishing an appropriate pattern of takes to restore ratability.

(c) Purchasers of natural gas, including pipelines and their subsidiaries or affiliates, which purchase gas from more than one field must take a consistent percentage of the aggregate deliverability to that purchaser from each field, unless the purchaser can demonstrate a just and reasonable basis for discriminating between fields.

(d) A pipeline which transports gas from producing wells in a field may not discriminate between wells in the field which offer their gas for transport. Pipelines which transport gas for

hire shall make their transportation facilities available on a fair and equitable basis to all wells in the field which offer their gas for transport.

(e) Purchases from limited wells (wells incapable of producing the full allowable they would receive under the allocation formula, designated by the commission with a # or @ symbol) shall not be reduced until all other wells in the field connected to that pipeline are reduced to the level at which that limited well can produce. Below that point, purchases from all prorated wells and limited wells should be reduced ratably.

(f) Operators shall apportion purchasers' take requests ratably to all wells in each field without discrimination as provided in subsections (a)-(d) of this section.

(g) Purchasers of gas shall satisfy their demand for gas by taking gas, up to the assigned allowable or limit for each well, from the following categories, in order:

(1) all casinghead gas and/or "garbage gas" connected directly to the pipeline;

(2) all gas from wells which have been assigned special allowables by the commission;

(3) gas from wells subject to Statewide Rule 49(b), but only to the extent of one full allowable in the case of multiple 49(b) wells;

(4) gas from prorated wells, including limited wells (see subsection (d) of this section).

(h) Any producer who is denied the opportunity to produce a ratable share of gas by a pipeline or purchaser, in violation of this rule, may file a complaint with the commission and request an order to end the discriminatory practices.

(i) If a producer fails to comply with a purchaser's request to ratably reduce production after reasonable [9 TexReg 4812 September 11, 1984] notice by the purchaser, the purchaser

may file a complaint with the commission and request an order directed at the producer to reduce production to ratable levels.

This agency hereby certifies that the proposal has been reviewed by legal counsel and found to be within the agency's authority to adopt.

Issued in Austin, Texas, on August 28, 1984.

TRD-849087 Walter Earl Lilie
Special Counsel
Railroad Commission of Texas

Proposed date of adoption:
November 5, 1984
For further information, please call (512) 445-1186.

Miscellaneous

16 TAC § 3.91

(Editor's note: The text of the following rule proposed for repeal will not be published. The rule may be examined in the offices of the Railroad Commission of Texas, 1124 IH 35 South, Austin, or in the Texas Register office, Room 503E, Sam Houston Building, 201 East 14th Street, Austin.)

The Railroad Commission of Texas proposes the repeal of § 3.91, concerning the ratable taking of natural gas. The repeal is being replaced by simultaneously proposed new § 3.34.

Patrick Thompson, Oil and Gas Division legal examiner, has determined that for the first five-year period the repeal will be in effect there will be no fiscal implications for state or local government or small businesses as a result of the repeal.

Mr. Thompson also has determined that for each year of the first five years the repeal is in effect the public benefit anticipated as a result of the repeal is the accommodation of the adoption of the proposed new section. The merits of the new section are discussed in a separate proposal. The anticipated economic cost to individuals who are required to comply with

the new rule will not vary from the cost under the existing section in any definable way.

Comments on the proposal may be submitted to Patrick Thompson, Legal Section, Oil and Gas Division, Railroad Commission of Texas, P.O. Drawer 12967, Austin, Texas 78711.

The repeal is proposed under the Texas Natural Resources Code, § 111.083 and § 111.090, which provides the Railroad Commission of Texas with the authority to prevent, by regulation, discriminatory purchasing or taking of natural gas.

§ 3.91. *Gas Market Demand, Allocation of Gas Well Allowables, and Ratable Take Between Gas Wells and Gas Fields.*

This agency hereby certifies that the proposal has been reviewed by legal counsel and found to be within the agency's authority to adopt.

Issued in Austin, Texas, on August 28, 1984.

TRD-849089 Walter Earl Lilie
Special Counsel
Railroad Commission of Texas

Proposed date of adoption:
November 5, 1984
For further information, please call (512) 445-1186.

[9 TexReg 4813, September 11, 1984]

Office-Supreme Court, U.S.
FILED
FEB 4 1985
ALEXANDER L. STEVAS,
CLERK

No. 84-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

VS.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., *et al,*
Appellees.

On Appeal from the Supreme Court of Mississippi

MOTION TO DISMISS, OR IN THE ALTERNATIVE TO AFFIRM DECISION OF THE SUPREME COURT OF MISSISSIPPI

WALKER L. WATTERS
(Counsel of Record)
DAVID T. COBB
GERALD, BRAND, WATTERS, COX & HEMLEBEN
400 Lamar Life Building
Post Office Box 158
Jackson, Mississippi 39205
Telephone: (601) 948-3030

WILLIAM C. DENTON
GETTY OIL COMPANY
Post Office Box 60252
New Orleans, Louisiana 70160
Telephone: (504) 595-1295

Attorneys for Appellee,
GETTY OIL COMPANY

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

QUESTIONS PRESENTED

Appellee, Getty Oil Company,[1] seeks dismissal of the appeal herein and/or affirmance of the decision of the Supreme Court of Mississippi on the ground that the appeal does not raise a substantial question requiring the consideration of this Honorable Court.

---

[1]The following companies are parent companies, subsidiaries, and affiliates of the Appellee, Getty Oil Company: Texaco, Inc.

TABLE OF CONTENTS

	Page
STATEMENT OF THE CASE	2
THE QUESTIONS ARE NOT SUBSTANTIAL	5
I. STATE "RATABLE TAKE" REGULATIONS OF UNREGULATED HIGH COST GAS ARE NOT PREEMPTED BY FEDERAL REGULATIONS OF NATURAL GAS PURCHASED	5
II. RULE 48 AND ORDER NO. 409-82 IN NO WAY CONSTITUTE AN UNDUE BURDEN ON INTERSTATE COMMERCE	18
CONCLUSION	27

TABLE OF AUTHORITIES

CASES	Page
Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n.,—U.S.—, 76 L.Ed.2d 1 (1983)	17, 18, 24
Associated Gas Distributors v. FERC, 706 F.2d 344, 345 (D.C. Cir. 1983)	12
Cities Service Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179, 95 L.Ed. 190, 71 S. Ct. 215 (1950)	9, 21, 23
Conoco, Inc. v. Federal Energy Regulatory Comm'n., 622 F.2d 796, (5th Cir. 1980)	10
Exxon Corporation v. Governor of Maryland, 437 U.S. 117 (1978)	24, 25
Federal Power Comm'n. v. Corporation Comm'n., 362 F.Supp. 522 (W.D. Okla. 1973), *aff'd.* 415 U.S. 961 (1974)	22
Federal Power Comm'n. v. Louisiana Power & Light Co., 406 U.S. 621 (1972)	7
Hines v. Davidowitz, 312 U.S. 52, 67 (1941)	17
Minnesota v. Cloverleaf Creamery Co., 449 U.S. 456 (1981)	24, 25
Natural Gas Pipeline Co. v. Panoma Corp., 349 U.S. 44 (1955)	9
Northern Natural Gas Co. v. State Corporation Comm'n., 372 U.S. 84 (1963)	6, 8, 9, 15, 21
Northern Natural Gas Co. v. State Corporation Comm'n., 362 P.2d 599 (Kan. 1961), rev'd 372 U.S. 84 (1963)	2
Panhandle Eastern Pipeline Co. v. Public Safety Commission of Indiana, 332 U.S. 507 (1947)	7
Pennsylvania v. West Virginia, 26 U.S. 553 (1923)	22
Phillips Petroleum Co. v. Oklahoma, 340 U.S. 190 (1950)	9
Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954)	4, 8
Pike v. Bruce Church, 397 U.S. 137 (1970)	21, 23, 26

Table of Authorities Continued

Page

Public Service Commission v. Mid-Louisiana Gas Co.,— U.S.—, 77 L.Ed.2d 668, 103 S.Ct.—(1983) . 15, 16, 23

Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 235 (1947) 17

Tenneco, Inc. v. Sutton, 530 F.Supp. 411 (M.D.La. 1981) 10, 11

Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board, 457 So.2d 1298 (Miss. 1984) 1, 23, 26

AUTHORITIES:

15 U.S.C.A. §§ 717-717z 6, 7, 9, 12, 14
§§ 3301-3432 6
§§ 3317(c); (A-61) 9
§§ 3431 ..... 9, 12, 14

MISCELLANEOUS:

7 U.S. Code Cong. and Admn. News, 1978, p. 9040 ... 10

43 Fed. Reg. 56455-58, Dec. 1, 1978 12-14

Statewide Rule 48 of the Mississippi State Oil and Gas Board 18, 22-23, 24, 26

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

VS.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., *et al,*
Appellees.

On Appeal from the Supreme Court of Mississippi

MOTION TO DISMISS, OR IN THE ALTERNATIVE, TO AFFIRM DECISION OF THE SUPREME COURT OF THE UNITED STATES

Getty Oil Corporation, one of the Appellees herein, files this Motion, respectfully requesting this Honorable Court to dismiss the appeal herein, or in the alternative, to affirm the decision and judgment of the Supreme Court of Mississippi in *Transcontinental Gas Pipe Line v. State Oil and Gas Board of Mississippi*, 457 So.2d 1298 (Miss. 1984). In support of this Motion, Appellee, Getty Oil Corporation, submits that this appeal does not raise a substantial federal

question which necessitates consideration by this Honorable Court.

STATEMENT OF THE CASE

Appellee does not take issue with the statement of the case as set forth in Appellant's jurisdictional statement, except for Appellant's statement that the Board's order had the practical effect of forcing Transco to take quantities of high cost gas it had no contractual obligation to take.

The Board's order did not force Transco to take quantities of high cost gas it had no contractual obligation to take. Transco could elect to take no gas at all. The Board's order merely provided that if Transco elected to take any gas from the pool, it should take ratably without discrimination in favor of one owner against another. If Transco elected to take gas from one owner, it had to take gas from all owners. The Mississippi Supreme Court's ruling is that Transco could only be required to take without discrimination as to quantity; Transco is not required to pay a nondiscriminatory price. Presumably, Transco will pay the market clearing price for gas belonging to parties with whom it does not have a sales contract establishing the price.[2]

Additional facts are helpful in determining the purpose of Rule 48 and the Natural Gas Policy Act of 1978 (NGPA).

1. The physical properties of gas make it necessary to regulate the taking of gas from reservoirs so that each party owning an interest in a gas reservoir will obtain his fair share of production. The problem presented in this case is described in a similar ratable take case, *Northern Natural Gas Co. v. State Corporation Comm.*, 362 P.2d 599 (Kan. 1961), rev'd 372 U.S. 84 (1963):

---

[2]Market clearing price means a price which Transco can pay to producers which will not be too high to sell to its customers.

> We do not read the record to show that there is any contention but that drainage was occurring, and that the underproduced wells were loosing the right to produce gas from the common source of supply to the great damage of the owners of the wells and the loss of their correlative rights.
>
> While members of this Court make no claim to be experts in the science of the production of natural gas, we believe that the Court may take judicial notice of the fact that where natural gas is within the earth in one common source and is under pressure, if one gas well is allowed to take gas, this will result in the pressure being lowered around the vicinity of this gas well so that the gas in the common source will tend to drain or rush to the vicinity of the well taking gas. The result will be that the other wells in the common field or source will be able to produce much less gas and the owners of such wells will have suffered a definite loss.

Prior to July, 1982, Transco took all of the gas produced from the six wells completed in the Harper Sand Gas Pool. As a result, it took ratably from each well and each owner in each well received his fair share of production from the pool. After Transco refused to take gas that it was not contractually obligated to take, disproportionate withdrawals of gas resulted. Transco was obligated to take all of the gas produced from the Florida Exploration 29-1 Well and the Florida Exploration - Carlisle 4-2 Well and as a result took all of the gas those two wells were capable of producing. Accordingly, Transco took one hundred percent of the allowable for these two wells.[3] Transco did not have gas sales

---

[3]Rules 33 and 34 promulgated by the Mississippi State Oil and Gas Board base the amount of gas a well may produce upon the amount of gas it is capable of producing; this allowed producing rate is called the well's allowable.

contracts with all of the owners of interests in the other four wells, namely the Getty-Rogers 28-11 Well, the Getty-Sipp 20-9 Well, the Getty-Buckley 33-6 Well and the Tomlinson-Willoughby 3-5 Well. Consequently, it only took gas from these four wells in proportion to the amount of interests in each well that it was contractually obligated to take. For example, if Transco had gas sales contracts with owners of approximately seventy percent of the gas in a well, Transco took an amount of gas from this well equal to seventy percent of the well's allowable. The result was that gas was drained from the underproduced Getty operated units to the Florida Exploration operated units, whose production was not cut back.

Coastal Exploration, Inc., the owner of a small interest in the Getty operated units, did not have a gas sales contract with Transco and initiated the instant suit by filing a petition with the Mississippi State Oil and Gas Board seeking, among other matters, to require Transco to take ratably the gas of all parties so that it could obtain its share of production from the pool.

2. The Natural Gas Policy Act was enacted as a result of the gas shortage in the 1970's. Subsequent to the *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954) decision, and prior to the enactment of the NGPA in 1978, no interstate pipeline company would purchase gas without the approval of the Federal Power Commission (FPC). Through its power to approve or disapprove the sale of gas in interstate commerce, the FPC could control the price of gas sold in interstate commerce. During this period, the FPC could also prevent a producer from withdrawing its gas from interstate commerce without abandonment authorization from the FPC.

This FPC regulation was onerous to the producer. A producer was reluctant to sell its gas in interstate commerce because it had to have FPC approval to do so and once it was sold in interstate commerce it could not remove without permission of the FPC. Furthermore, the FPC, through its approval power, kept the price of gas artificially low. As a result, the producer had little incentive to explore for additional gas reserves. This decline in exploration for new gas reserves resulted in diminishing gas reserves in this country. By the 1970's, there was a shortage of deliverable gas. When new gas reserves were discovered they were often sold in the unregulated intrastate market where they could be sold at market value and without the regulatory impediments the FPC imposed on gas sold in interstate commerce. One of the purposes of the NGPA was to remove the disparity between the interstate and intrastate markets. This was in part accomplished by Section 601 which deregulated high cost gas sold in interstate commerce.

THE QUESTIONS ARE NOT SUBSTANTIAL

I. State "Ratable Take" Regulations of Unregulated High Cost Gas Are Not Preempted by Federal Regulations of Natural Gas Purchased.

Transco contends that the enactment of the NGPA raises a substantial question of whether Congress, by deregulating prices of the first sales of certain categories of gas, intended to allow states to regulate the quantity and price of gas purchased by an interstate pipe line and transported for sale in the interstate market. The question as applied to this case is not properly posed. Congress not only deregulated the price of high cost gas, in Section 601 of the NGPA it also removed the first sales of deregulated high cost gas from the jurisdiction of FERC. FERC no longer has any authority to approve or disapprove of the first sale of high cost gas into

interstate commerce. Likewise, it no longer has jurisdiction to require that said gas, once sold in interstate commerce, remain in interstate commerce. A producer does not have to get FERC approval to take gas out of interstate commerce through abandonment proceedings. The question is whether state regulatory agencies can again require interstate pipelines to purchase ratably high cost gas deregulated under the NGPA. The following authorities indicate the NGPA removed first sales of high cost gas from FERC jurisdiction, thereby allowing state regulatory agencies to resume ratable take jurisdiction which these agencies exercised prior to *Northern Natural Gas Co. v. State Corporation Comm'n.*, 372 U.S. 84 (1963).

Transco asserts that the Board may not issue a ratable take order affecting an interstate gas pipeline without running afoul of the doctrine of federal preemption. Transco claims that the jurisdiction of the FERC is so sweeping that it extends to all wellhead purchases of gas by the interstate pipelines FERC regulates. The power of FERC to regulate sales of gas in interstate commerce, however, is defined by and limited to the powers delegated to it by the Natural Gas Act.[4] FERC's NGA jurisdiction, in turn, has been so circumscribed by the Natural Gas Policy Act[5] that its jurisdiction over Transco does not attach until the Transportation link of the Pipeline's system.

Section 1 (b) of the Natural Gas Act, 15 U.S.C.A. § 717 (b), the jurisdictional section of said Act, clearly defines the scope of the Natural Gas Act, to-wit:

> The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the

---

[4]15 U.S.C.A. §§ 717-717z.

[5]15 U.S.C.A. §§ 3301-3432.

> sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

In 1947, the United States Supreme Court, in *Panhandle Eastern Pipeline Company v. Public Service Commission of Indiana*, 332 U.S. 507 (1947), examined Section 1(b) of the Natural Gas Act and defined the powers granted to the Federal Power Commission:

> This section [Section 1 (b)] determines the Act's coverage and does so in the light of the situation existing at the time. Three things and three only Congress drew within its regulatory power, delegated by the act to its agent, the Federal Power Commission. These were: (1) the transportation of natural gas in interstate commerce; (2) its sale in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or sale.

Id. at 516. This statement was quoted with approval in *Federal Power Commission v. Louisiana Power & Light Co.*, 406 U.S. 621 (1972).

Based upon the language of the Natural Gas Act itself, as well as the abovementioned cases, it is clear that the Commission's jurisdiction, although wide ranging, is less than plenary. The Commission's grant of jurisdiction flows from Section 1 (b) of the Natural Gas Act. It can regulate the activities of producers and pipelines only insofar as it is permitted to do so by the Act.

Aside from the question of preemption by the Federal Government, the constitutionality of ratable take statutes and orders directed at non-producing purchasers has never been challenged.

Regarding federal preemption of state ratable take orders, in *Northern Natural Gas Co. v. Corporation Commission of Kansas*, 372 U.S. 84 (1963), the United States Supreme Court decided that the orders of the Kansas State Corporation Commission which required an interstate pipeline company to purchase gas ratably from all wells connected with its pipeline system in each gas field within the state invalidly encroached upon the exclusive regulatory jurisdiction of the Federal Power Commission conferred by the Natural Gas Act. The Court held as it did because at that time, the Federal Power Commission, by virtue of the Natural Gas Act and the Supreme Court's decision in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), which applied the Natural Gas Act to sales of gas from independent producers to interstate pipelines, was given exclusive jurisdiction over the sale and transportation of natural gas in interstate commerce for resale. No interstate pipeline company could purchase gas without the approval of the FPC. The FPC controlled the price paid for gas in acquisitions by pipeline companies. Under the regulatory scheme created by the Natural Gas Act, no room was left either for direct state regulation of the prices of interstate wholesales of natural gas, or for state regulations which would indirectly achieve the same result. State ratable take orders, in the opinion of the Supreme Court, affected the ability of the Federal Government, acting through the Federal Power Commission, "to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act." (372 U.S. at 91-92).

It should be noted, however, that the *Northern Natural* decision did not purport to overturn *Cities Service v. Peerless*, which upheld the constitutionality of state ratable take orders. In a footnote, the Court stated:

> Our decisions in *Cities Service Gas Company v. Peerless Oil & Gas Company*, 340 U.S. 179, 95 L.Ed. 190, 71 S.Ct. 215, and *Phillips Petroleum Company v. Oklahoma*, 340 U.S. 190, 95 L.Ed. 204, 71 S.Ct. 221, are not contrary. 'In those cases, we were dealing with constitutional questions and not the construction of the Natural Gas Act.' *Natural Gas Pipeline Company v. Panoma Corp., supra*, (349 U.S. at 45).

372 U.S. at 91, n. 10.

However, since all of the wells completed into and producing from the Harper Sand Gas Pool have been classified by the State Oil and Gas Board as deep, high cost gas wells under Section 107(c) of the Natural Gas Policy Act of 1978,[6] and the gas from these wells was not dedicated to interstate commerce on November 8, 1978, the gas produced from these wells does not come within the ambit of the Natural Gas Act, and consequently, the *Northern Natural* decision is not applicable to this case.

Section 1(b) of the Natural Gas Act of 1938, *supra*, conferred upon the Federal Power Commission's exclusive jurisdiction over the sale and transportation of gas in interstate commerce. Section 601 of the Natural Gas Policy Act of 1978,[7] provides that as to all high cost natural gas as defined in Section 107(c), "for purposes of Section 1 (b) of the Natural Gas Act, the provisions of such act and the jurisdiction of the Commission (FERC) under such act" are not applicable.

---

[6]15 U.S.C.A. § 3317 (c); (A-61).

[7]15 U.S.C.A. § 3431.

This means that FERC has no jurisdiction over the field sales of deregulated gas which is the subject of this litigation.

The legislative history of the Natural Gas Policy Act amplifies Section 601 by stating:

> Natural gas not committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act is never made subject to the Commission's jurisdiction under Sec. 1 (b) of the Natural Gas Act.
>
> The commission's jurisdiction under Section 1 (b) of the Natural Gas Act ceases on the first day of the first month beginning after the date of enactment of this Act for the following categories of natural gas:
>
> 1. High cost natural gas which qualifies for deregulation price treatment under Section 107(c).

7 U.S. Code Cong. and Adm. News, 1978 at 9040.

In *Conoco, Inc. v. Federal Energy Regulatory Commission*, 622 F.2d 796, (5th Cir. 1980), the Fifth Circuit explained the effect of Section 601:

> Section 601 (a) of NGPA, 15 U.S.C.A. Section 3431 (a), exempts certain categories of natural gas from the jurisdiction of FERC and the requirement of obtaining a certificate of public necessity under NGA. . . . It is clear from Section 601 that Congress intended to free certain natural gas from FERC jurisdiction, while leaving other gas subject to that jurisdiction.

Id. at 797, and 799.

In *Tenneco, Inc. v. Sutton*, 530 F.Supp. 411 (M.D.La.1981), the District Court there succinctly summarized the effect of the NGPA:

> THE NGPA is basically an overlay of the NGA since the NGA remains applicable to interstate transportation and interstate sales for resale, *unless a specific exclusion of the NGA jurisdiction is provided.* The NGPA eliminates many of the NGA's price and nonprice producer regulations. Under the provisions of the NGPA, the NGA is inapplicable after November 3 1980 [sic], to first sales of natural gas which were not committed or dedicated to interstate commerce on November 8, 1978, and to first sales of committed or dedicated gas which have been determined to be new natural gas, new onshore production well gas, or within certain categories of high cost gas. These provisions remove the Commission's authority to establish just and reasonable prices under the NGA for producer sales into the interstate market and to indirectly regulate these sales through control of the interstate pipeline purchaser's pass-through of purchase gas costs. These provisions also relieve producers of gas not committed or dedicated to interstate commerce and gas in the new natural gas and new onshore production well categories and certain high cost categories, from any requirement of receiving certification or abandonment authorization, or of making rate filings under the NGA.
>
> Impediments to producer sales into the interstate market of natural gas which was not committed to that market at the time the NGPA was enacted are eliminated.

Id. at 419. (Emphasis added).

Transco argues that since sales of natural gas by interstate pipelines to distribution companies continue to be regulated, such regulation is sufficient to confer exclusive

federal jurisdiction over the present issue. However, Section 601(b)[8] of the NGPA provides that "for purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any first sale of natural gas shall be deemed to be just and reasonable if . . . there is no applicable maximum lawful price solely by reason of the elimination of price control." (Sections 4 and 5 of the Natural Gas Act, 15 U.S.C.A. §§ 717c and d, require that all rates in connection with the sale or transportation of a natural gas shall be just and reasonable). Furthermore, Section 601(c)[9] states that FERC may not deny any interstate pipeline recovery of any amount paid with respect to any purchase of natural gas if . . . such amount is deemed to be just and reasonable for purposes of section 4 and 5 of such Act . . . except to the extent "the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds." *Associated Gas Distributors v. FERC*, 706 F.2d 344, 345 (D.C.Cir. 1983).

In the preamble to its interim rules implementing the Natural Gas Policy Act, FERC explained the effect of the NGPA upon continued NGA regulation:

> If gas is not committed or dedicated to interstate commerce as defined in Section 2(18) or is exempted from the jurisdiction of the NGA under Section 601(a) (1) (B) as high cost natural gas, new natural gas, or natural gas produced from any new onshore production well, the prior framework of utility type regulation under the NGA no longer applies.
>
> If natural gas sales are freed from the requirements of the NGA, several adjuncts to NGA regulation are obvi-

---

[8]15 U.S.C.A. § 3431 (b).

[9]15 U.S.C.A. § 3431 (c).

ated. First, there is no longer any necessity for a producer to seek certification of the sale as serving the public convenience and necessity. The replacement for this requirement under the NGPA is limited to the prior determination mechanism, where applicable, and the pricing limits established in the NGPA. New sales of such gas in interstate commerce no longer require certification as a prerequisite to commencement of deliveries. Nor does the requirement for abandonment authorization before termination of deliveries of natural gas exist with respect to natural gas no longer subject to NGA regulation. In the case of first sales of natural gas not previously committed or dedicated to interstate commerce or exempted from NGA regulation, tariff filings and rate increase applications are dispensed with. (Of course, specific requirements for filing to establish the right to collect the maximum lawful price levels exist under the regulations and annual reporting will be required under the NGPA in many instances. However, the nature of these filings, which are in many cases one-time notification type filings, is quite different from the rate filings previously required under the NGA.

Indirectly, NGA regulation is affected by the operation of Section 601 (b) and (c) of the NGPA. Section 601 (b) provides that any amount paid in any first sale of natural gas shall be deemed to be just and reasonable if such amount does not exceed the maximum lawful ceilings established by the NGPA or if there is no maximum lawful price applicable by reason of elimination of price controls, Section 601(c), the guaranteed pass-through provision, states that the Commission may not deny, or condition the grant of any certificate under Section 7 of the NGA based upon the amount paid in any sale of

> natural gas if the amount paid meets the standard of Section 601(b) and is, therefore, by statutory fiat, just and reasonable. Additionally, the Commission may only deny recovery by any interstate pipeline of any amount paid with respect to the purchase of natural gas under Section 601 (b) to the extent the Commission determines that the amount paid was excessive due to fraud, abuse or similar grounds.

43 Fed.Reg. 56455-58, Dec. 1, 1978.

Moreover, with respect to the status of pipeline purchasers of deregulated gas, Section 601 (a) (1) (D)[10] of the Natural Gas Policy Act provides as follows:

> D. Natural Gas Company—For purposes of the Natural Gas Act, the term "natural gas company" (as defined in Section 2(6) of such Act) shall not include any person by reason of, or with respect to, any sale of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission do not apply to such sale solely by reason of subparagraph (A), (B), or (C) of this paragraph.

Section 2 (6)[11] of the Natural Gas Act defines a "natural gas company" as "a person engaged in the transportation of natural gas in interstate commerce, for the sale in interstate commerce of such gas for resale."

Read together, these statutory passages directly affect Transco's status as a purchaser of natural gas. When Transco purchases gas which is removed from FERC's jurisdiction by Section 601 (a) (1) (A), (B), or (C), as to those purchases, Transco, too, is removed from the FERC's NGA

---

[10]15 U.S.C.A. § 3431 (a) (1) (D).

[11]15 U.S.C.A. § 717a(6).

jurisdiction, for it is no longer a "natural gas company" subject to FERC's jurisdiction under the NGA. Although FERC's NGA jurisdiction over Transco remains as to the *transportation* of gas in interstate commerce, the NGPA expressly provides that Transco, as a purchaser of this deregulated gas, is not regulated by FERC.

Thus, the *Northern Natural* decision is clearly inapplicable as to Transco's purchases of deregulated gas such as the Harper Sand Gas Pool. Both the gas in question and the pipeline which purchases it are, by the operation of the Natural Gas Policy Act, removed from the ambit of the Natural Gas Act. With respect to deregulated gas, FERC's jurisdiction over Transco's activities begins in the transportation link of the interstate pipeline system. Transco's field purchases of deregulated gas are not regulated by the Commission. FERC's authority, which is defined by Section 1 (b) of the Natural Gas Act, and which is circumscribed by the operation of the Natural Gas Policy Act, does not, in the case of deregulated gas, back up to the wellhead. Such an assertion is, when read in light of the applicable statutes, impossible. Such an interpretation of the NGPA would make Section 601 and the intent of Congress in enacting the NGPA meaningless.

In *Public Service Commission of New York v. Mid-Louisiana Gas Co.*, —U.S.—, 77 L.Ed.2d 668 (1983), the Supreme Court examined in detail the history of regulation by the federal government of the natural gas industry. In so doing, the Court observed that the NGPA took FERC out of the business of regulating field purchases of natural gas by pipelines:

> The NGPA is designed to preserve the Commission's authority under the NGA to regulate natural gas sales from pipelines to their customers; however, it is de-

> signed to supplant the Commission's authority to establish rates for the wholesale market, the market consisting of so-called 'first sales' of natural gas.

Id. at 678.

The only possible reason that can be given for preemption is the possible impact that the Board's order may have on Transco's resale prices. This is because FERC can in no way regulate Transco's field purchasing practices. No longer must Transco obtain a certificate of convenience and necessity before it may purchase the gas it transports in interstate commerce. No longer must a certificate of abandonment be obtained to remove gas from the interstate market. No longer is there justification to preempt a state's ratable take order on the ground that it might disrupt the federally controlled pricing scheme for natural gas, because this scheme no longer exists as to deregulated gas. The NGPA allows Transco to buy Section 107 gas at any price in order to meet its supply obligations. Only if FERC finds that Transco's purchase costs are excessively inflated due to fraud or abuse may its resale rates be reduced.

Transco cites no authority for the proposition that FERC has jurisdiction over wellhead sales of gas expressly deregulated by the NGPA. These cases merely set forth the general rule that when Congress intends for FERC to occupy a field, then the states cannot regulate that field. Getty does not take issue with this principle. However, it does disagree with Transco's contention that Congress, after the NGPA, intends to occupy the field of first sales of deregulated gas. The NGPA, the preamble to the interim rules, the foregoing cases, and the history of the gas shortage leading up to the NGPA all clearly indicate that Congress intended to remove FERC jurisdiction from first sales of deregulated gas.

In *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941), the Supreme Court stated that a state law is preempted if it "stands as an obstacle to the accomplishment of the full purposes and objectives of Congress." And in *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 236 (1947), the Court noted that the test of preemption is whether "the matter on which the State asserts the right to act is in any way regulated by the federal government." Here, it is the stated objective of Congress to increase the supply of gas in the interstate market by removing certain categories of gas from the web of FERC's jurisdiction. Congress has expressly removed from FERC's purview wellhead sales of deregulated gas.

Furthermore, Transco's assertion that Order No. 409-82 interferes with FERC's pervasive interest in regulation of the sale of natural gas in interstate commerce does not by itself lead to the conclusion that the Board is preempted from applying Rule 48 to an interstate gas pipeline. In *Arkansas Electric Cooperative Corporation v. Arkansas Public Service Commission*, —U.S.—, 76 L.Ed.2d 1 (1983), AECC and the United States, as amicus curiae, argued that the Arkansas PSC's assertion of jurisdiction interfered with the federal Rural Electrification Administration's "pervasive involvement in the management of the rural power cooperatives to which it loans funds, and may frustrate important federal interests." (*Id.* at 11). The Court ignored this broad assertion and instead analyzed the true relation between the Rural Electrification Act and state regulatory jurisdiction over wholesale electricity rates as explained in the legislative history of that Act:

> Contrary to the suggestion in the dissent, we do not infer from this legislative history that Congress either 'authorized' or 'expected' state regulation that this Court had barred states from engaging in. [Citations omitted]. The relevant inquiry, however, is not whether

> Congress authorized or expected such regulation, but whether it intended by its own actions to *forbid* it. Cf. *Pacific Gas & Elec. Co. v. State Energy Resources Development Comm'n.*, 461 —U.S.— 76 L.Ed.2d—, 103 S.Ct.—(1983). In answering that question, we look quite naturally to whether Congress intended in any way to forbid state regulation of rural power cooperatives.

Id. at 12, n. 11.

The message from Congress is not only clear, but is paramount: FERC's jurisdiction over Transco's field purchases of deregulated gas does not begin until after said gas has entered the transportation link of the interstate gas pipeline system. Since there is no jurisdiction, there is nothing to preempt, and Rule 48 and Order No. 409-82 do not violate the Supremacy Clause of the Constitution.

II. Rule 48 and Order No. 409-82 in No Way Constitute an Undue Burden on Interstate Commerce.

Transco's attempt to make a commerce clause issue is based upon five erroneous assumptions.

First, Transco argues that Rule 48 requires it to take high cost gas that it is not contractually obligated to take. The Mississippi Supreme Court construed Rule 48 as only requiring Transco to take (quantities) ratably from all owners. It expressly stated that Rule 48 did not deal with price discrimination and that Transco would not be required to pay the Getty $7.90/MM Btu price that Coastal sought. Rule 48 in no way establishes the price to be paid for the uncommitted gas. Presumably Transco will pay the market value for this gas.

Secondly, Transco claims that any commerce clause inquiry must consider take or pay provisions. Take or pay

provisions as noted by Transco, have been in interstate contract provisions for many years. They are the result of a bargain to satisfy the needs of both the producer and the purchaser. The producer wants a predictable and regular flow of money from his well so that he can handle debt financing and other business needs. The purchaser wants relief from the obligation to take a fixed quantity of gas from a well each month, since the ability of the purchaser, to dispose of the gas depends upon the weather and other unpredictable factors. The compromise is the take or pay provision which gives the producer a steady flow of income and at the same time allows the purchaser the flexibility to reduce takes at times when it cannot market high volumes of gas and thereby allows him to take "make up" gas at a later time when he has an increased need for gas. Although the purchaser must pay for gas not taken up to the contract minimum, when he later takes that gas (make up gas), he doesn't pay for it since he has already paid for it. The only burden on the purchaser is the loss of use of the money from the time he pays for the gas and the later date that he actually takes the gas. This burden is apparently one that the purchaser is willing to assume to obtain flexibility in the takes of gas. At the hearing before the Board, Transco's witness admitted that it was aware of Rule 48 when it executed the gas contracts involved in the case. Transco cannot complain because it willingly included take or pay provisions in these contracts. The consumer cannot complain because these provisions were necessary to obtain the gas which, at the time these contracts were executed, was in short supply. Take or pay provisions in gas contracts are in wide use in all producing states and are not an undue burden on interstate commerce.

Third, Transco alleges that it is forced to take additional volumes of gas. Rule 48 does not force Transco to take any

volume of gas. It merely states that if Transco elects to take any gas, it shall take ratably from all owners. The volumes of gas that Transco takes depends solely upon Transco's choice. The Mississippi statute cited in Transco's brief (Miss. Code Ann. § 53-1-1 (1972)), relates to the amount that a well is *allowed* to produce. There is no statute or rule that requires the well to be produced at the allowable or at any other rate.

Fourth, Transco contends that Mississippi should have regulated producers instead of purchasers. This approach would not have protected the rights of all parties in the pool. Purchasers control production because a producer can deliver only that amount of gas that a pipeline will allow into its lines. Transco's witness stated in the hearing before the Mississippi State Oil and Gas Board that Transco would not take any gas that it was not contractually obligated to take unless the Board ordered it to do so. Since Transco has different percentages of committed gas in different units, the result will be undue drainage between units. The owners of interests in the underproduced units will not get their fair share of production.

Fifth, Transco says that Congress provided price escalation and price deregulation in the NGPA to encourage exploration. This is true in part. It did approve price escalations and price deregulation as an incentive, but it further provided complete deregulation of first sales of high cost (Section 107) gas. Artificially low prices were only part of the regulatory burdens that caused producers to avoid the interstate market. Also annoying to producers were the regulations which prohibit sales into the interstate market without FERC (FPC) approval or removal of gas from the interstate market with FERC approval. To encourage producers to plan high cost gas producers to send gas into the

interstate market it removed the first sales of this gas from *all* FERC regulation.

This Court has previously upheld state ratable take orders such as Statewide Rule 48 when those orders were challenged under the Commerce Clause. *Cities Service Gas Company v. Peerless Oil and Gas Co.*, 340 U.S. 179 (1950). Moreover, the holding in *Cities Service* that a ratable take order does not violate the Commerce Clause was specifically approved in this Court's decision in *Northern Natural Gas Co. v. State Corporation Commission*, 372 U.S. 84 (1963), upon which Transco relies so heavily in its jurisdictional statement. Nevertheless, Transco now asks this Court to ignore these precedents and find Statewide Rule 48 in violation of the Commerce Clause.

In *Pike v. Bruce Church*, 397 U.S. 137 (1970), this Court set forth the following test to be applied in Commerce Clause challenges:

> Where the statute regulated evenhandedly to effectuate a legitimate public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

Id. at 142.

Thus, applying the first part of the *Pike* test, a state regulation will be upheld where:

1. It regulates evenhandedly to effectuate a legitimate local public interest; and,

2. Its effects on interstate commerce are only incidental.

It is absurd to say that Statewide Rule 48 discriminates against Transco or any interstate company in favor of Mississippi producers. This rule applies evenhandedly to all field producers of oil and gas, be they interstate pipeline or local oil purchasers. Furthermore, Statewide Rule 48 does not restrict the flow of natural gas into the interstate market, a result of state regulation which was condemned in *Pennsylvania v. West Virginia*, 262 U.S. 553 (1923), where a West Virginia statute required domestic gas producers to supply local needs first before allowing the surplus gas, if any, into the interstate market. Nor does it threaten to withdraw large reserves of natural gas from the interstate market as did the Oklahoma Corporation Commission's order in *FPC v. Corporation Commission*, 362 F.Supp. 522 (W.D. Okla.1973), *aff'd.* 415 U.S. 961 (1974). The Commerce Clause was meant to protect against the burdens on interstate commerce condemned in the above mentioned cases, and not against state ratable take requirements.

On the contrary, Rule 48 is a uniform, evenhanded prohibition on discriminatory purchasing practices by purchasers from a pool. Any purchaser, whether interstate or intrastate in nature, is subject to Statewide Rule 48, regardless of the purpose for which the gas is purchased. Furthermore, Statewide Rule 48 does not require Transco to purchase any set volumes of gas. It may take one hundred percent, fifty percent, or none. Transco's only obligation is that once it decides to take gas from a pool, it must take those quantifies ratably from the wells and the owners who offer their gas for sale. There is nothing in Statewide Rule

48 that requires Transco to increase its take in Mississippi over those in Louisiana or Texas, as Transco claims.

Moreover, Transco cannot argue that Statewide Rule 48 does not regulate so as to effectuate a legitimate local public interest, that being the protection of the coequal and correlative rights of owners of natural resources in Mississippi.

Therefore, since Statewide Rule 48 regulated evenhandedly to effectuate this legitimate local public interest, and since its effect on interstate commerce, if any, is only incidental, it must be upheld under the *Pike* test.

Transco's argument that Statewide Rule 48 impermissably affects interstate commerce because it would result in higher prices to consumers is not determinative of the Commerce Clause question. First, higher prices to consumers in another state do not render a state's regulation of commerce impermissable under the Commerce Clause. *Cities Service Company v. Peerless Oil and Gas Company*, 340 U.S. 179, 186-87 (1950). Secondly, Congress has declared that all reasonable costs of production of deregulated natural gas shall be borne ultimately by the consumer. This is one of the fundamental policy determinations underlying the Natural Gas Policy Act of 1978. See, *e.g.*, *Public Service Commission v. Mid-Louisiana Gas Co.*, —U.S.—, 77 L.Ed.2d 668, 103 S.Ct. — (1983) (costs of providing production and incentives are plainly to be shouldered by down stream consumers, not pipelines). Thus, as pointed out by the Mississippi Supreme Court in its decision, "whether increased prices to consumers may be fairly characterized as an incidental burden upon interstate commerce, we find it persuasive that Congress within the scope of its power under the affirmative Commerce Clause has expressly authorized its increases." *Transcontinental Gas Pipeline*, *supra*. at page 1321.

Moreover, the burdens on interstate commerce caused by Statewide Rule 48 as set forth by Transco are in reality, nothing but speculative and hypothetical examples of an imagined burden on interstate commerce, and such speculative and hypothetical possibilities are not sufficient to challenge a state regulation under the Commerce Clause. *Arkansas Electric Cooperative Corporation v. Arkansas Public Service Commission*, —U.S.— 76 L.Ed.2d 1, 17-18, 103 S.Ct. — (1983).

Finally, and most importantly, any burdens resulting to Transco's operations in interstate commerce by enforcement of Statewide Rule 48 are not the result of Statewide Rule 48, which simply requires that whatever gas the pipeline takes from a common source be taken ratably, but rather are the result of Transco's contracts with the producers herein. As has been previously stated, Statewide Rule 48 does not require a pipeline company to purchase any set volumes of gas. It is free to take any amount it desires from a well so long as it takes ratably from all producers in the well. It is Transco's contracts with the producers that determine the amount of gas it must take. These contracts were voluntarily entered into by Transco with full knowledge of Statewide Rule 48 and the Natural Gas Policy Act of 1978. And this Court has numerous times held that the Commerce Clause does not protect interstate *firms* from the impact of state regulations when the flow of interstate commerce is not affected. *Minnesota v. Cloverleaf Creamery Co.*, 449 U.S. 456 (1981); *Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978).*

In the *Exxon* case, the State of Maryland enacted a statute forbidding refiners and producers of petroleum products from operating their own stations within the state. If Exxon wished to sell its products in Maryland, such products were required to be sold by independent service

stations. Exxon was required to divest itself of the stations which it operated itself. Exxon and the other refiners/producers so affected charged that the Maryland statute violated the Commerce Clause.

Noting that the Maryland statute would have no impact on the flow of interstate commerce, this Court, stated, "The fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce." *Id.* at 126. Responding to Exxon's claim that Maryland had interfered with the natural functioning of the interstate markets through burdensome regulation, this Court replied that it could not accept Exxon's argument that the Commerce Clause "protects the particular structure or methods of operation in a retail market." *Id.* at 127. It is exactly this argument that Transco makes when it asks this Court to consider the specific terms of its contract with Getty in determining the Commerce Clause issue, and this Court has held that it will not do so.

Similarly, in the *Cloverleaf* case, this Court held that a Minnesota statute banning retail sales of milk in plastic jugs, but permitting sales of milk in paper cartons, was not violative of the Commerce Clause. Noting that the statute did not affect the flow of interstate commerce, the Court followed its decision in the *Exxon* case, and held that the Commerce Clause "protects the interstate market, not paticular interstate firms, from prohibitive or burdensome regulations." *Minnesota v. Cloverleaf Creamery Co., supra.* at page 474, qu oting *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 127-128 (1978).

As the Mississippi Supreme Court has so succinctly stated in its opinion herein, any burdens resulting from

enforcement of Statewide Rule 48 fall only on Transco and not on the interstate market:

> The fundamental flaw in Transco's reasoning on the burden point is that it seems to be talking much more about a burden upon Transco than a burden upon interstate commerce. The burden upon Transco appears traceable to its contract with Getty, not to Rule 48. That contract is one that Transco freely and voluntarily entered with Getty. It is had to see how a ratable take rule or order could be said to generate an unreasonable burden on interstate commerce when the only thing requiring Transco (or any other interstate pipeline) to take at all, ratably or otherwise, is its own contract.

Transcontinental Gas Pipeline, 457 So.2d 1322.

Transco also argues that the State of Mississippi has an alternative method to achieve its stated purpose. However, Transco has failed to show that the burden imposed on interstate commerce by enforcement of Statewide Rule 48 is "clearly excessive in relation to the putative local benefits". Therefore, under the *Pike* test, it is not necessary to consider other alternatives, and Statewide Rule 48 being one that regulates evenhandedly to effectuate a legitimate public interest and one whose effect on interstate commerce are incidental, must be upheld. *Pike*, *supra*. at 178.

CONCLUSION

All the challenges raised by Transco to Statewide Rule 48 must fail in light of clear Congressional intent and previous decisions of this Court. There is, therefore, no substantial question of federal law which has not previously been settled by this Court and/or Congress and Transco's appeal herein should be dismissed, or in the alternative, the decision of the Mississippi Supreme Court should be affirmed.

Respectfully submitted,

WALKER L. WATTERS
(Counsel of Record)
DAVID T. COBB

OF COUNSEL:

GERALD, BRAND, WATTERS, COX & HEMLEBEN
Suite 400, Lamar Life Building
Post Office Box 158
Jackson, Mississippi 39205
(601) 948-3030

WILLIAM C. DENTON
GETTY OIL COMPANY
Post Office Box 60252
New Orleans, Louisiana 70160

Office-Supreme Court, U.S.
FILED
MAR 4 1985
ALEXANDER L. STEVAS,
CLERK

No. 84-1076

In The

Supreme Court of the United States

October Term, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,

Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., et al,

Appellees.

On Appeal from the Supreme Court of Mississippi

COASTAL EXPLORATION, INC.'S MOTION TO DISMISS OR, IN THE ALTERNATIVE, TO AFFIRM THE DECISION OF THE SUPREME COURT OF MISSISSIPPI

GLENN GATES TAYLOR,
Counsel of Record
KENNETH I. FRANKS
JAMES RUSSELL TUCKER
HEIDELBERG, WOODLIFF & FRANKS
Suite 1400 Capital Towers
Jackson, Mississippi 39201
(601) 948-3800

Attorneys for Coastal Exploration, Inc.

March 1, 1985

COCKLE LAW BRIEF PRINTING CO., (800) 835-7427 Ext. 333

BEST AVAILABLE COPY

QUESTIONS PRESENTED

1. *The Preemption Question:* Do the Natural Gas Act of 1938 (NGA) and the Federal Energy Regulatory Commission's (FERC) jurisdiction under § 1(b) of the NGA apply to the "first sale" of gas which has been determined to be deregulated "deep, high-cost natural gas" under Section 107 of the Natural Gas Policy Act of 1978 (NGPA)?

2. *The Commerce Clause Question:* Does the requirement that an interstate gas purchaser must offer to take federally-deregulated gas ratably from the wells which produce from a gas pool and must offer to pay the non-contract owners in the pool a "market price" for their gas constitute a burden on interstate commerce?

TABLE OF CONTENTS

	Pages
This Case Should Be Dismissed Or Affirmed	1
Summary of the Argument	1
Statement of the Case	4
The State Interests Sought to be Effected and the Conditions Placed on Transco's Takes of Gas.	4
What the State Has Not Required.	6
Argument	9
I. The Presumption Question Is Not Substantial.	8
Peerless	9
Phillips	10
Northern Natural	11
The NGPA	13
Section 601 of the NGPA	15
There is No Arguable Conflict Between Mississippi's Ratable Take Requirement and the NGA/NGPA	17
II. The Commerce Clause Question Is Not Substantial.	19
Conclusion	24

CASES:

Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, 461 U.S. 375 (1983)	3, 20
Cities Service Gas Company v. Peerless Oil & Gas Company, 340 U.S. 179 (1950)	passim
Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981)	20
Conoco, Inc. v. FERC, 662 F.2d 796 (5th Cir. 1980)	16
Energy Reserves Group, Inc. v. Kansas Power and Light Co., — U.S. —, 103 S.Ct. 697 (1983)	12
Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978)	20

TABLE OF AUTHORITIES

	Pages
Mid-Louisiana Gas Co. v. FERC, 664 F.2d 530 (5th Cir. 1981)	13
Minnesota v. Cloverleaf Creamery Co., 499 U.S. 456 (1981)	20
Northern Natural Gas Co. v. State Corporation Commission of Kansas, 372 U.S. 84 (1963)	passim
Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission, — U.S. —, 103 S.Ct. 1713 (1983)	3, 20
Pennzoil Co. v. FERC, 645 F.2d 378	13, 15, 16, 17
Pike v. Bruce Church, Inc., 79 U.S. 137 (1970)	3, 20
Public Service Commission v. Mid-Louisiana Gas Co., — U.S. —, 103 S.Ct. 3024 (1983)	12
Tenneco, Inc. v. Sutton, 530 F.Supp. 411 (M.D. 1981)	14
Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board of Mississippi, 457 So.2d 1298 (Miss. 1984)	1, 8, 22
STATUTES:	
Miss. Code Ann. § 53-1-1 (1972)	5
Miss. Code Ann. § 53-1-3(k) (3) (1972)	5
Natural Gas Policy Act of 1978	11
Natural Gas Policy Act, Section 1(b)	12
Natural Gas Policy Act of 1978, Section 107	1
Natural Gas Policy Act, Section 107(c) (1)	8
Natural Gas Policy Act of 1978, Section 601(a) (1)	passim
Natural Gas Policy Act of 1978, Section 601(a) (1) (A) & (B)	8
OTHER AUTHORITY:	
FPAS § 601:220	15

THIS CASE SHOULD BE DISMISSED OR AFFIRMED

This case should be dismissed or, alternatively, the decision of the Mississippi Supreme Court should be affirmed for lack of a substantial federal question because it is clear that the simple state ratable take requirement at issue does not directly or indirectly conflict with either the NGA or the NGPA, nor does the requirement constitute a burden on interstate commerce. Because Congress has so clearly and unequivocally declared that the NGA and FERC's jurisdiction under the NGA *never* apply to the first sale and purchase of the federally-deregulated gas in question, a state, once again, is free to make the simple two-fold requirement that, if and when a gas purchaser takes federally-deregulated gas from a gas pool, (1) the purchaser must offer to take whatever quantities of that gas it desires ratably from the wells which produce from the pool (in order to prevent drainage, reservoir damage and "waste", and to afford each owner in the pool the opportunity to recover his share of gas), and (2) when the gas is actually taken, the purchaser must offer to pay a market price for the gas of those owners with whom the purchaser does not have a written contract. *Transcontinental Gas Pipe Line Corp. v. State Oil & Gas Board of Mississippi*, 457 So.2d 1298, 1327, 1331 (Miss. 1984).

———o———

SUMMARY OF THE ARGUMENT

1. *The Preemption Question:* Do the NGA and FERC's jurisdiction under Section 1(b) of the NGA apply to the "first sale" of gas which has been determined to be deregulated "deep, high-cost natural gas" under Section 107 of the Natural Gas Policy Act of 1978 (NGPA)? No. The answer to that narrow question lies in the clear language of Section 601(a)(1) of the NGPA. Some case history is in order. In *Cities Service Gas Company v. Peerless Oil & Gas Company,* 340 U.S. 179 (1950), the Court rejected constitutional challenges to a state ratable take/minimum price order entered against an interstate gas purchaser. The Court, however, did not consider the effect of the NGA on the validity of such an order. That effect was considered thirteen (13) years later in *Northern Natural Gas Co. v. State Corporation Commission of Kansas,* 372 U.S. 84 (1963), which held invalid a state ratable take order directed against an interstate pipeline company because the state's order invaded the Federal Power Commission's (FPC) *then-existing* exclusive regulatory jurisdiction under Section 1(b) of the NGA, jurisdiction and regulatory authority which, at that point in time, extended to a producer's sale and a pipeline's purchase of natural gas destined for the interstate market. That jurisdiction and that regulatory authority were eliminated by Congress in 1978 when it enacted the NGPA. Specifically, Section 601(a)(1) of the NGPA provides that the first sale of, *inter alia,* deregulated "deep, high-cost natural gas" natural gas is *never* made subject to either the NGA or FERC's jurisdiction under the NGA. Because FERC no longer has any statutory authority to regulate the first sale transaction involving that category of natural gas, the statutory reasons for the result in

Northern Natural no longer exist in the case of that category of gas, and the state, once again, is free to enforce a ratable take requirement to that first sale transaction. *Peerless, supra.*

2. *The Commerce Clause Question:* Does the requirement that a gas purchaser must offer to take federally-deregulated gas ratably from the wells which produce from a pool and must offer to pay the non-contract owners in the pool a "market price" for their gas constitute a burden on interstate commerce? No. That precise question was answered thirty-five (35) years ago in *Peerless,* which rejected the claim that a state ratable take order violates the Commerce Clause. *Northern Natural,* decided on narrow statutory grounds, noted that *Peerless* remained good law as to the constitutional challenges to a state ratable take order. *Stare decisis,* however, is not the only reason why the Commerce Clause "question" in this case is not substantial. It is undisputed that there is no actual conflict or collision between the federally-deregulated first sale and purchase transaction which the state seeks to affect, and the subsequent pipeline transportation and resale activities which FERC continues to regulate on a modified basis. The most that can be said is that, on a purely hypothetical basis, there might at some point be some incidental, but as yet undefined, effect on interstate commerce but, given the strong legitimate state interests and local benefits sought to be effected by the state action, the possibility that an incidental effect might be felt somewhere by someone does not rise to the level of a prohibited "excessive" burden on interstate commerce, if a burden at all. *Peerless, supra; Pike v. Bruce Church, Inc.,* 79 U.S. 137, 142 (1970); *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission,* 461 U.S. 375 (1983); *Pacific Gas &*

Electric Co. v. State Energy Resources Conservation & Development Commission, — U.S. —, 103 S.Ct. 1713 (1983).

———o———

STATEMENT OF THE CASE

The facts giving rise to this case are largely, if not wholly, undisputed and are set forth in the opinion below. 457 So.2d at 1307-1312.

Our discussion relevant to the question of whether this Court should note probable jurisdiction most appropriately begins with a review of the state interests sought to be effected, the simple conditions which the state has placed on Transco's takes of gas, and, almost as important, what the state has not required of Transco.

The State Interests Sought to be Effected, and the Conditions Placed on Transco's Takes of Gas

The state ratable take requirement at issue is intended to prevent reasonably avoidable drainage between gas units, to afford each "owner" in a pool the opportunity to recover his just and equitable share of gas from a pool, and to make that opportunity meaningful by giving each owner access to the market which is available at the wellhead. The requirement also protects a given owner in a pool from discriminatory and irrational treatment by a gas purchaser simply because of who the owner *is not*, or the relatively small size of the owner's interest, or the owner's lack of business sophistication and economic bargaining power. Given that the owners in a pool are possessed of "co-equal and correlative rights" and that "gas is gas", there is no reasonable or rational basis for a gas purchaser who takes gas from a pool refusing to deal with some of the owners in the pool, or offering to

buy an owner's gas, but on terms which are substantially different from those extended to other owners in the same pool.

Under Mississippi law, each owner in a pool of oil and gas is possessed of "co-equal and correlative rights" in a pool of oil and gas so that each owner "may obtain his just and equitable share of production therefrom." Miss. Code Ann. § 53-1-1 (1972). To this end, the Board is empowered to protect against "waste" which is defined to include:

> "Abuse of the correlative rights and opportunities of each owner of oil or gas in a pool due to non-uniform, disproportionate, or unratable withdrawals causing undue drainage between tracts of land or resulting in one or more owners in such pool producing more than his just and equitable share of the production from such pool."

Miss. Code Ann. § 53-1-3(k)(3) (1972). These principles, of course, are not unique to Mississippi; they are uniform to all of the oil and gas producing states.

The state's ratable take requirement at issue implements these principles, is two-fold and is very simple: First, if and when a gas purchaser takes federally-deregulated gas from a pool, the purchaser must offer to take whatever quantities of gas the purchaser desires ratably from all of the wells in order to allow each owner in the pool the opportunity to recover his just and equitable share of oil and gas, to prevent some owners from recovering more than their just and equitable share, and to prevent drainage and reservoir damage, caused by unratable and disproportionate takes of gas from the wells which produce from a pool. Second, for the gas of those owners who do not have a contract with the purchaser, but who want to sell their federally-deregulated gas, the

purchaser must offer to pay a "reasonable price, determined by reference to prevailing market conditions and other appropriate economic considerations," 457 So.2d at 1331, in order to make meaningful those owners' right to recover their just and equitable share of production from the pool.

Without the benefit of this state protection, an owner in a pool, particularly an owner of a small interest, can easily find himself denied the opportunity to recover his just and equitable share of gas in the pool because of, *inter alia,* an operator or co-owners who attempt to allocate all production to themselves, or a purchaser who refuses to buy the owner's gas. That is precisely the quandry in which Coastal found itself in the Summer of 1982. That is precisely what led to the state ratable take order in question.

What the State Has Not Required

Given the many misrepresentations that have been made about what the state supposedly has required of Transco, it is an appropriate time to consider just what the state has *not* required.

The state has not required Transco to take more gas than it needs, nor to take the full allowable of any well(s), nor to take the full allowable of any pool, nor to give any producer a contract, nor to pay anyone "take-or-pay money," nor to pay a fixed price, nor to pay a higher-than-market price--nor to take any gas at all. Thus, Transco's representations that Mississippi has required production "in excess of market demand" has no basis in fact. It is a misrepresentation, pure and simple.

The six-well pool in question has an "allowable" which, under state law, is the maximum amount of gas

which may be taken from the pool. The allowable is based on the "maximum efficient rate of production" by all of the wells which produce from the pool. Thus, the allowable for the pool is *the ceiling,* not the floor, on production and takes of gas. In any given month or period of time, Transco, judging what its needs are, may take 100% of the pool's allowable, or 1% of the pool's allowable, or no gas at all. The conditions Mississippi has placed on Transco's takes of deregulated gas do not require Transco to take more expensive gas to the exclusion of cheaper gas, nor to favor Mississippi gas over other states' gas, nor to pay the non-contract owners the "highest price" paid in the field. The state's requirement is simple: When and if Transco decides to take the federally-deregulated gas from the pool in question, Transco must offer to take the gas it needs ratably from the wells which produce from the pool and, unless Transco and an owner agree otherwise, Transco must offer to pay an owner with whom it has no purchase contract a "reasonable price, determined by reference to prevailing market conditions and other appropriate economic considerations." 457 So.2d at 1331. The state has not even attempted to dictate what that price should be. Transco has responded to this requirement by paying the non-contract owners a "market-out" price.

These are the *only* conditions which the State of Mississippi has placed on Transco's takes of gas from the deregulated gas pool in question. The conditions are simple and easily complied with. Witness the undisputed fact that, since December 1982, Transco has been taking gas ratably from the pool and paying a "market-out" price for the gas of the non-contract owners.

ARGUMENT

I.

THE PRESUMPTION QUESTION IS NOT SUBSTANTIAL

The preemption question in this case[1] is not substantial because the plain, unequivocal language of Section 601 (a)(1)(A)&(B) of the NGPA and the accompanying Conference Report of Congress so clearly state that the first sale and purchase of the federally-deregulated natural gas in question[2] no longer is subject to either the NGA or FERC's jurisdiction under the NGA. Thus, as to the federally-deregulated gas at issue, Section 601(a) (1) has eliminated what has always been the *only* statutory reason for invalidating a state ratable take requirement.

How did we come to this point? By two roads. First, down a road of NGA/FERC regulation of the first sale transaction between a producer and an interstate gas purchaser, a comprehensive regulation which ultimately led to artificially low NGA-mandated "just and reasonable" wellhead prices, low prices which led to a lack of incentive for producers to drill for new gas and sell that gas into

---

[1]The preemption question as framed by Transco is not merely inaccurate and imprecise—it is ridiculously overstated, presumably for "shock effect." The question has never been framed that way in the proceedings to date. To the contrary, the preemption question has always been, what is now the relevance and application of *Northern Natural* to NGPA—deregulated natural gas in light of NGPA Section 601(a) (1)? *Transco, supra,* 457 So.2d at 1315.

[2]The gas in question is both deregulated gas (meaning that it has been classified as "deep, high-cost gas" under NGPA Section 107(c) (1), and undedicated gas (meaning that it was not committed or dedicated to interstate commerce as the day before the date of enactment of the NGPA). See NGPA Section 601(a) (1).

interstate commerce, a lack of incentive which ultimately led to the severe interstate gas shortages of the mid-1970s, shortages which have been described as a "national crisis." That is the same road which led to the *Phillips* decision in 1954 and to *Northern Natural* in 1963.

The nation's recovery from that abysmal situation began in 1978 when Congress turned down a second road, a road of NGPA regulation-to-deregulate which eliminated the difference between the interstate and intrastate markets, and provided producers and interstate gas purchasers alike with the degree of freedom from federal regulation and with the price incentives which Congress determined were needed in order to allow the price of gas *to rise* and encourage producers to discover and produce new gas and sell that gas into the interstate market. NGPA Section 601(a)(1) was the vehicle used to eliminate federal regulation of the first sale and purchase of certain types of natural gas, including the deregulated natural gas at issue. It is the elimination of that federal regulation which has freed the state, once again, to apply a simple ratable take requirement to the first sale and purchase of federally-deregulated gas. The state's authority to make that kind of requirement was recognized by this Court thirty-five (35) years ago in *Peerless*.

Peerless

The producer in *Peerless* found itself in virtually the same quandry as did Coastal: The interstate gas purchaser who was buying from the pool first refused to buy Peerless' gas at all, and then offered to buy the gas at a price which was lower than that being paid to other own-

ers in the field. The state conservation commission then entered a ratable take order requiring the purchaser to take gas ratably from the pool and to pay Peerless a fixed minimum price. This Court, in a unanimous decision, rejected challenges to the order made on the grounds of the Due Process, Equal Protection and Commerce Clauses.[3]

In *Peerless,* however, the Court made the cryptic observation that it was not considering the effect the NGA might have on a state ratable take order. That effect was considered thirteen years later in *Northern Natural,* which was decided after the 1954 decision in *Phillips.*

Phillips

At the time *Peerless* was decided, the NGA had not been construed to apply to the first sale transaction between a producer and an interstate gas purchaser. Four (4) years later, however, the Court's decision in *Phillips* extended the NGA, and the FPC's jurisdiction thereunder, to cover a producer's sale of gas to an interstate pipeline, thus allowing the FPC to determine whether the gas could be sold into interstate commerce and whether the sales price was "just and reasonable." Distinguishing *Peerless,* the Court reiterated the aim of the NGA:

> "Protection of consumers against exploitation at the hands of natural-gas companies was the primary aim of the Natural Gas Act. * * *"

---

[3]In a companion case to *Peerless, Phillips Petroleum Co. v. Oklahoma,* 340 U.S. 190 (1950) the Court upheld a similar minimum price order issued by the Oklahoma Corporation Commission.

347 U.S. at 685. *Phillips* launched a twenty-five (25) year period during which the FPC (later FERC), under Section 1(b) of the NGA, controlled all facets of a producer's sale and an interstate pipeline's purchase of gas. The "red tape" was so burdensome and the "just and reasonable" prices set by the FPC were so artificially low that, as the years passed by, the prices provided little or no incentive for producers to develop new gas reserves and sell that gas into the interstate market. The "pay-off" for the "protection of consumers" philosophy turned out to be a severe shortage of gas on the *federally*-regulated interstate market, while there developed a corresponding surplus of gas on the *state*-regulated intrastate market.

Northern Natural

Northern Natural was an extension of *Phillips*. The Court, in a less-than-unanimous decision, held invalid a ratable take order which the Kansas Corporation Commission entered against an interstate pipeline company because the state order invaded what was *then* the FPC's exclusive regulatory jurisdiction under Section 1(b) of the Natural Gas Act of 1938 (NGA):

> "We disagree with the Kansas Supreme Court, for we hold that the State Commission's orders did invade the exclusive jurisdiction which the Natural Gas Act has conferred upon the Federal Power Commission over the sale and transportation of natural gas in interstate commerce for resale."

372 U.S. at 89. The limited statutory basis for the result in *Northern Natural* is evidenced by the fact that the Court was careful to point out that it was not overruling

Peerless.[4] Thus, the state order was not invalidated because of some vague concern about the "imminent possibility of conflict" with federal law; it was invalidated on a narrow statutory ground because of a direct and ascertainable conflict with the FPC's *then existing* exclusive jurisdiction[5] under Section 1(b) of the NGA to grant or

---

[4]372 U.S. at 91, note 10. *Peerless* was most recently cited in a NGPA context in *Energy Reserves Group, Inc. v. Kansas Power and Light Co.*, — U.S. —, 103 S.Ct. 697 (1983). There, the Court cited *Peerless* for its holding that a state has the power to regulate natural gas prices and sales so long as that regulation does not interfere with the Commerce Clause:

> "State authority to regulate natural gas prices is well established. *See Cities Service Gas Co. v. Peerless Oil & Gas Co.* * * *
>
> "On several occasions, the Court has approved state price regulation of natural gas that did not interfere with interstate commerce. See, e.g., . . . *Cities Service Gas Co. v. Peerless Oil & Gas Co.* * * *"

— U.S. at —; 103 S.Ct. at 706, notes 16 & 17.

[5]The Court in *Northern Natural* stated that with respect to the NGA "[t]he Congress enacted a comprehensive scheme of federal regulation of *'all wholesales* of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company.' " 372 U.S. at 91. [Emphasis added]. Compare *that* pre-NGPA view of the Court with the Court's post-NGPA view of the state of the scheme of federal regulation, in *Public Service Commission v. Mid-Louisiana Gas Co.*, — U.S. —, 103 S.Ct. 3024 (1983):

> "The NGPA is designed to preserve the Commission's authority under the NGA to regulate natural gas sales from pipelines to their customers; *however, it is designed to supplant the Commission's authority to establish rates for the wholesale market, the market consisting of so-called 'first-sales' of natural gas.*" — U.S. at —, 103 S.Ct. at 3031. [Emphasis added].

deny the entry of gas into the interstate market, and to fix the "just and reasonable" wellhead sales price of that gas. It was precisely that jurisdiction which was eliminated by NGPA Section 601(a)(1).

The NGPA

In enacting the NGPA, Congress had two central goals: First, to provide price incentives to producers to drill more gas wells, find new gas and put that new gas into the interstate market. Second, to free producers and pipelines from those regulatory features of the NGA and FERC's jurisdiction which were discouraging producers from selling gas to the pipelines and were crippling pipelines' ability to purchase new gas.[6]

Those congressional goals were reached by Congress, first, eliminating FERC's NGA-jurisdiction and powers to require a producer and a pipeline to obtain FERC's approval of the entry of new gas into the interstate market and the price to be paid by the pipeline for that gas, and, second, enacting immediate price deregulation for some new gas (like "deep, high-cost gas" under Section 107), and gradual price deregulation for other new gas (like gas under Sections 102 and 103). Sections 121 and 601 of the NGPA accomplished these goals.

---

[6]See, e.g., *Pennzoil Co. v. FERC*, 645 F.2d at 378: "The NGPA is a fundamental change in regulatory outlook. * * * FERC has a fundamentally different regulatory obligation. . . . The balance Congress struck already took into account the conflicting interests of producers and consumers." In *Pennzoil*, the Court concluded that the effect of § 601(a)(1)(A) was to deny FERC the authority to regulate or interpret gas purchase contracts covering "undedicated" gas. *Id.* at 380. *See also Mid-Louisiana Gas Co. v. FERC*, 664 F.2d at 530, 535 (5th Cir. 1981).

Section 121 provided producers with the price incentives needed to encourage them to find new gas and sell that gas into the interstate market. Thus, Section 121 immediately eliminated price controls for Section 107 "deep, high-cost gas" and set a 1985 date for price deregulation of other new gas, such as gas qualifying for pricing under Sections 102 and 103. Section 121 thus furnished *the price incentives* which Congress intended.

Section 601 provided producers and pipelines with the freedom from regulatory interference by FERC with a pipeline's purchase and a producer's sale of new gas in order to enable a pipeline to freely compete for new gas by allowing the pipeline to pay a producer the higher incentive prices or deregulated prices for new gas (without *ever* having to get FERC approval of the prices paid or the other terms of the contract) and to exempt a pipeline and a producer alike from the then existing regulatory constraints of the NGA and FERC's jurisdiction under the NGA, constraints which had combined with low FERC-set "just and reasonable" prices to produce the severe gas shortages of the late 1970s caused by the producers' reluctance (and sometimes refusal) to sell their gas to interstate commerce, and the pipelines' inability to buy new gas from the producers. Section 601 thus furnished the pipelines and the producers with *the degree of freedom from regulatory interference* by FERC which Congress intended.[7]

---

[7]*See*, e.g., *Tenneco, Inc. v. Sutton*, 530 F.Supp. 411, 419 (M.D. 1981): "These provisions [Section 601] remove the Commission's authority to establish just and reasonable

(Continued on next page)

Section 601 of the NGPA

Section 601(a)(1) eliminates FERC's NGA-jurisdiction to control, or regulate, either directly or indirectly, a producer's sale and a pipeline's purchase of deregulated gas.[8] Thus, Section 601(a)(1) eliminates the NGA re-

---

(Continued from previous page)

prices under the NGA for producer sales into the interstate market and to indirectly regulate these sales through control of the interstate pipeline purchaser's pass-through of purchase gas costs."

See also the "Curtis/Jackson Letter", Federal Programs Advisory Service (FPAS) § 601:220 (9-8-78), on Section 601: "This section [601] executes the legislative intent to remove from Natural Gas Act utility type regulation natural gas not heretofore dedicated or committed to interstate commerce (§ 601(a) (1) (A), and to remove from Natural Gas Act-type regulation heretofore jurisdictional sales of high cost gas, gas from new OCS leases, new well qualifying for the new natural gas price under section 102, and [103 gas] (§ 601 (a) (1) (B)." FPAS § 601:220, page 2.

[8]The "Joint Explanatory Statement of the Committee on Conference" of the Congress, which accompanied the NGPA, is extremely important because it states in plain English what Section 601(a)(1) means:

> "The Conference Agreement limits the jurisdiction of the Commission under the Natural Gas Act in a manner similar to the House-passed bill.
>
> Natural gas not committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act is *never* made subject to the Commission's jurisdiction under sec. 1(b) of the Natural Gas Act. The Commission's jurisdiction under section 1(b) of the Natural Gas Act *ceases* on the first day of the first month beginning after the date of enactment of this Act for the following categories of natural gas:
>
> High-cost natural gas which qualifies for deregulated price treatment under section 107(c) (1), (2), (3), or (4); * * *" [Emphasis added].

See, e.g., Pennzoil Co. v. FERC, supra, 645 F.2d at 378.

quirement that the parties must first obtain from FERC a certificate of public convenience and necessity as to new gas, and removes FERC's jurisdiction and power to set a "just and reasonable" price and dictate contract terms. The *effect* of this particular sub-section is that neither the producer nor the pipeline ever has to obtain the previously required certificate of public convenience and necessity in order to sell and buy this type of new gas.[9] Because the parties do not have to obtain a certificate from FERC, FERC cannot use its NGA power (to grant or deny a certificate) to control purchases, contract terms and price, as it did prior to enactment of the NGPA.[10] Nor can FERC, pursuant to its NGA jurisdiction over a "natural gas company," control the price which a pipeline, like Transco, pays for the gas on the grounds that

---

[9]*See*, e.g., *Conoco, Inc. v. FERC*, 662 F.2d 796, 797, 799 (5th Cir. 1980). *See also* FERC's Preamble to the issuance of the first interim regulations issued after the NGPA was passed, 43 F.R. 56448 (12-1-78), wherein FERC observed the effect of the NGPA on the NGA:

> "If gas is not committed or dedicated to interstate commerce . . . or is exempted from the jurisdiction of the NGA under section 601(a) (1) (B) as [107 or 102 or 103 gas] the prior framework of utility-type regulation under the NGA no longer applies.
>
> If natural gas sales are freed from the requirements of the NGA, several adjustments to NGA regulations are obviated. First, there is no longer any necessity for a producer to seek certification of the sales as serving the public convenience and necessity."

[10]*See*, e.g., *Pennzoil Co. v. FERC, supra*, in which the court held that FERC no longer has jurisdiction to regulate or interpret gas purchase contracts covering undedicated gas or dedicated gas which is also 107 or 102 or 103 gas: "In other words, section 601(a) (1) (A) prevents the universe of gas subject to the NGA from expanding." 645 F.2d at 380.

Transco is an otherwise regulated "natural gas company." Section 601(a)(1)(D) takes care of that potential problem by providing that neither party to the first sale transaction of deregulated gas shall be considered to be a "natural gas company" with respect to its purchase of deregulated gas.

Section 601(b) and (c) protect a pipeline from an after-the-purchase attack by FERC on the price paid by the pipeline for deregulated gas. Section 601(b) provides that all prices which a pipeline pays for deregulated gas are deemed "just and reasonable" as a matter of law, and Section 601(c) provides that the pipeline has the guaranteed statutory right to pass-through the price which it pays for deregulated gas and include that price in its resale rates charged to consumers, unless the price is the result of "fraud, abuse or similar grounds."[11]

There Is No Arguable Conflict Between Mississippi's Ratable Take Requirement and the NGA/NGPA

Obviously, the NGPA regulatory scheme is vastly different from the NGA regulatory scheme which prevailed when *Northern Natural* was decided. There *now* is neither an actual nor a hypothetical conflict between the state ratable take requirement at issue and, on the other hand, the NGA and the NGPA.

To review, at the time *Northern Natural* was decided, the FPC (now FEPC) had two fundamental regulatory powers over gas which was destined for an interstate

---

[11]*See, e.g., Pennzoil Co. v. FERC, supra,* 645 F.2d at 379, n.38: "Section 601(c) (2) guarantees to interstate pipelines the ability to pass through NGPA payments."

market. First, before the gas could even enter the interstate market, the producer and pipeline had to obtain a certificate of public convenience and necessity from the FPC; they were not free to simply put the gas into the interstate market without FPC approval. Second, the price paid by the pipeline had to be first approved by the FPC as a "just and reasonable price"; the producer and pipeline were not free to simply negotiate a price. There were no ceiling prices as such, only "just and reasonable" prices, and there was no interstate gas which was not subject to federal price regulation.

That was the federal regulatory scheme with which the Kansas ratable take/minimum price order collided in *Northern Natural.* The order interferred with both of what were *then* the FPC's fundamental regulatory powers because the order forced gas into interstate commerce, without a *then* required certificate of public convenience and necessity, and set a minimum price to be paid for the gas, without a *then* required prior adjudication by the FPC that the minimum price was "just and reasonable".

What changed with enactment of the NGPA? First, a certificate of public convenience and necessity is no longer required before undedicated or deregulated gas can enter the interstate market; the producer and pipeline are free to put the gas into the interstate market at anytime. This, of course, is consistent with the overall goal of the NGPA—to get *more* gas into interstate commerce with less red tape. Second, FERC has no jurisdiction over and no authority to set the "first sale" price to be paid by the pipeline for deregulated gas; under Section 601(b)(1)(A) the price paid by the pipeline for deregulated gas is presumed to be "just and reasonable" and no FERC

approval is required before the pipeline can pay that price. Nor can FERC seek to influence or affect the first sale price paid by the pipeline through FERC's jurisdiction over the pipeline's resale rates; under Section 601(c), the pipeline has a guaranteed statutory pass-through of the price it pays for the gas, unless the price results from "fraud, abuse or similar grounds".

The state action at issue stops short of affecting any transaction which continues to be subject to the NGA or FERC's jurisdiction thereunder. The ratable take requirement affects only the wellhead "first sale" price and the initial entry of deregulated gas into the interstate market—it goes no further. It is a case of coincidental state and federal regulation. Where one stops the other starts, and neither infringes upon the other. *Peerless.*

The preemption question, therefore, is not substantial because it is so clear that the NGA and FERC's jurisdiction thereunder do not apply to the first sale of federally-deregulated natural gas, leaving the state free, once again, to attach the ratable take requirement at issue to an interstate pipeline's takes of federally-deregulated gas. *Accord, Peerless, supra.*

II.

THE COMMERCE CLAUSE QUESTION IS NOT SUBSTANTIAL

The Commerce Clause question in this case is not substantial because this Court has held that a state ratable take/minimum price order directed to an interstate gas purchaser does not violate the Commerce Clause. *Peerless, supra.* As we have pointed out, even *Northern*

Natural was careful to point out that *Peerless* remained good law on the constitutional challenges to the state order. 372 U.S. at 91, n. 10.

> "Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."

Pike v. Bruce Church, Inc., supra, 397 U.S. at 142. Applying that "new balancing test," the Court has accorded the states a wider berth and, consequently, has recently upheld a variety of state regulatory actions which have been carried out against a background of federal regulation. *See, Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, supra; Pacific Gas and Electric Co. v. State Energy Resources Conservation and Development Commission, supra; Exxon Corp. v. Governor of Maryland,* 437 U.S. 117, 127-29 (1978); *Minnesota v. Cloverleaf Creamery Co.,* 499 U.S. 456 (1981); *Commonwealth Edison Co. v. Montana,* 453 U.S. 609 (1981). No longer is the Court content to void state action because of the mere possibility that the state action might burden interstate commerce. An actual burden must be shown, and then the interests of the state are to be balanced against the actual burden on interstate commerce to determine if, in light of the "putative local benefits", the burden on interstate commerce is excessive.

Just what is the alleged excessive burden on interstate commerce in this case? The best evidence of the fickle nature of the alleged burden is Transco's own framing of the Commerce Clause question:

> "Does Mississippi's attempted regulation of interstate pipeline companys' purchase of 'high-cost' gas constitute an impermissible burden on interstate commerce *under present market conditions?*" [Emphaphis added].

This, of course, is a "weather vane approach" to the Commerce Clause: If the forecast is that compliance with the state requirement may cause Transco any kind of economic burden, then the state's requirement rises to the level of an excessive burden on interstate commerce. Individualized and seasonal burdens, however, are not what the Commerce Clause proscribes.

Factually, the alleged burden in this case is not some imagined "complex task" of balancing well production; there is no such complex task. The burden Transco complains of has its beginning and its end in a few of Transco's gas purchase contracts. Transco has entered into some relatively few gas purchase contracts under which Transco has agreed to pay some few producers two or three times the market price for their gas. Transco's gamble in entering into those contracts was that Transco could mix its expensive gas with its cheap gas and still have a marketable, price competitive and *profitable* product — one which would allow Transco to realize its maximum allowed rate of return. Transco also agreed to pay those few producers what Transco now considers to be "excessive" minimum annual payments, so-called "take-or-pay payments." Because of the reduced demand for gas in general, Transco claims that, if it offers to take gas from the non-contract owners in the six-well pool in question, then Transco's take-or-pay obligations to its contract owners in the pool *may* increase. Thus, behind Transco's representations that Mississippi has "forced" Transco to take "high-cost" gas are the facts that (1)

from time-to-time Transco has tied its ratable takes of gas from the pool to its minimum annual take obligations provided for in its contracts, in order to hold down its take-or-pay payments to its contract owners; (2) Transco is not incurring and *will never incur* any take-or-pay obligations to the non-contract owners; and (3) since December 1982, Transco has been paying the non-contract owners only a "market price" for their gas.

Thus, Transco's fickle characterization of the Commerce Clause "question" in this case is directly attributable to the fact that, but for the temporary reduced demand for gas and those relatively few of Transco gas purchase contracts in which Transco agreed to pay two or three times the market price for deep gas and to make "excessive" take-or-pay payments, all without the protection of a "market-out clause" which would allow Transco unilaterally to reduce those contract prices, it would be "convenient" for Transco to comply with the state ratable take requirement at issue. To paraphrase, there would be no burden on interstate commerce if Transco's "present market conditions" were "better."

Obviously, the "burden" in question is not a burden on interstate commerce in general, much less an excessive burden. The burden, if any, is *Transco's* burden which has been caused by some of *Transco's* contractual practices. Other pipelines, who were more conservative or prudent in their offers, do not have these "burdens." Thus, to indulge Transco's claim is to have the Commerce Clause question turn on the happenstance and vagaries of the marketplace or the economic miscalculations of one party or the other. It is to make the Com-

merce Clause a safe-harbor for one who has rolled the dice and lost.

The ultimate irony, of course, is that the state has not required Transco to take any set quantities of gas (as do Transco's contracts), nor has the state required Transco to pay more than a market price for any gas (as do some of Transco's contracts), nor has the state required Transco to make any take-or-pay payments (as do Transco's contracts). The state has required *only* that, if and when Transco takes federally-deregulated gas from the pool in question, Transco must offer to take that gas ratably from the wells which produce from the pool and must offer to pay the non-contract owners in the pool a market price—the very price which Transco ends each working day wishing that it could pay to all of its contract owners.

In conclusion, the simple ratable take requirement at issue is not a burden on interstate commerce "under present market conditions" or otherwise. The ridiculous misrepresentations of what the state allegedly has required of Transco have been made to divert attention from the undisputed fact that the *only* conceivable burden on anyone from complying with the state requirement at issue is the short-term "burden" that Transco *might* incur some contractual take-or-pay obligations to some of its contract owners. That contingency, if and when it ever matures and Transco actually makes the take-or-pay payments, might put Transco out of the time value of some refundable take-or-pay monies, but it does not constitute a burden on interstate commerce, much less rise to the level of a prohibited excessive burden on interstate commerce. Simply put, Transco's Commerce Clause claim is frivolous. *Peerless, supra.*

CONCLUSION

This case should be dismissed, or alternatively, the decision of the Mississippi Supreme Court should be affirmed for lack of a substantial federal question.

Respectfully submitted,

COASTAL EXPLORATION, INC.

By: GLENN GATES TAYLOR
(Counsel of Record)
KENNETH I. FRANKS
JAMES RUSSELL TUCKER
HEIDELBERG, WOODLIFF & FRANKS
Suite 1400 Capital Towers
Jackson, Mississippi 39201
(601) 948-3800

Office - Supreme Court, U.S.
FILED
MAR 1 1985
ALEXANDER L. STEVAS
CLERK

NO. 84-1076

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION
Appellant,

vs.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI
AND COASTAL EXPLORATION, INC., ET AL.
Appellees

ON APPEAL FROM THE SUPREME COURT
OF MISSISSIPPI

APPELLEES' MOTION TO DISMISS, OR IN THE ALTERNATIVE, TO AFFIRM THE DECISION OF THE SUPREME COURT OF MISSISSIPPI

Edwin Lloyd Pittman, Attorney General
State of Mississippi

Ed Davis Noble, Jr.
Assistant Attorney General
(Counsel of Record)

R. Lloyd Arnold
Special Assistant Attorney General

Post Office Box 220
Jackson, Mississippi 39205
(601) 359-3680

BEST AVAILABLE COPY

QUESTIONS PRESENTED

1. Appellee, The State Oil and Gas Board of Mississippi, seeks dismissal of the appeal of Transcontinental Gas Pipe Line Corporation on the grounds as alleged for the appeal are not substantial and do not require the consideration of this Court.

2. In the alternative, Appellee, The State Oil and Gas Board, seeks the affirmance of the decision of the Supreme Court of Mississippi.

TABLE OF CONTENTS

	PAGE
QUESTIONS PRESENTED	i
TABLE OF CONTENTS	ii
TABLE OF AUTHORITIES	iii-iv
STATEMENT OF THE FACTS	1
STATEMENT OF THE CASE	2-4
ARGUMENT	4-16
I. There Are No Substantial Federal Questions	4-11
II. Statewide Rule 48 Does Not Constitute An Impermissible Burden On Interstate Commerce	11-16
CONCLUSION	16-17
CERTIFICATE OF SERVICE	18-19

TABLE OF AUTHORITIES

CASES	PAGE
Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, ____ U.S. ____, 103 S.Ct. 1905, 1912, 76 L.Ed.2d 1, 10, (1983)----------	10
Bandini Petroleum Co. v. Superior Court, 284 U.S. 8, 76 L.Ed. 136, 52 S.Ct. 103----------	13
Federal Power Commission v. Transco, 365 U.S. 1, 5 L.Ed.2d 377, 81 S.Ct. 435 (1961)----------	8
Northern Natural Gas Co. v. State Commission of the State of Kansas, 372 U.S. 84, 9 L.Ed.2d 601, 83 S.Ct. 646 (1963)-------	4, 5, 8, 13
Patterson v. Standolina Oil and Gas Co., 305 U.S. 376, 83 L.Ed. 231, 59 S.Ct. 259----------	13
Transcontinental Gas Pipe Line v. State Oil & Gas Board of Mississippi, et al., 457 So.2d 1298 (Miss. 1984)----------	1
Valley Forge Christian College v. Americans United for Separation of Church & State, 422 U.S. 490, 70 L.Ed.2d 700, 102 S.Ct. 752 (1982)----------	14, 15

TABLE OF AUTHORITIES - Continued

CASES:	PAGE:
Walls v. Midland Carbon Co., 254 U.S. 300, 65 L.Ed. 276, 41 S.Ct. 118	13
STATUTES AND CONSTITUTIONAL:	
Article III, U.S. Constitution	14
15 U.S.C. §§ 3301 et seq.	10
OTHER:	
Section 601(c), Natural Gas Policy Act	14
Statewide Rule 48 of the State Oil & Gas Board	2, 8, 9, 10, 12, 13, 14, 15

NO. 84-1076

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION
Appellant,

VERSUS

THE STATE OIL AND GAS BOARD OF MISSISSIPPI
AND COASTAL EXPLORATION, INC., et al.
Appellees.

ON APPEAL FROM THE SUPREME COURT OF
MISSISSIPPI

MOTION TO DISMISS, OR IN THE ALTERNATIVE TO AFFIRM THE DECISION OF THE SUPREME COURT OF MISSISSIPPI

EDWIN LLOYD PITTMAN, ATTORNEY GENERAL
STATE OF MISSISSIPPI

ED DAVIS NOBLE, JR.
ASSISTANT ATTORNEY GENERAL
(Counsel of Record)

R. LLOYD ARNOLD
SPECIAL ASSISTANT ATTORNEY GENERAL

Post Office Box 220
Jackson, Mississippi 39205
Telephone: (601) 359-3680

APPELLEES' BRIEF IN SUPPORT OF MOTION TO DISMISS, OR IN THE ALTERNATIVE TO AFFIRM THE DECISION OF THE SUPREME COURT OF MISSISSIPPI

STATEMENT OF THE FACTS

The State Oil and Gas Board of Mississippi, one of the Appellees herein, files this its Motion to Dismiss, or in the Alternative to Affirm the Decision of the Supreme Court of Mississippi, in Transcontinental Gas Pipe Line v. State Oil and Gas Board of Mississippi, et al., 457 So.2d 1298 (Miss. 1984) and in support thereof submits to this Honorable Court that the issues sought to be raised by the Appellant do not raise substantial federal questions which merit consideration by the Court based on the facts as presented to the Supreme Court of Mississippi.

STATEMENT OF THE CASE

This appeal is an attack on the Supreme Court of Mississippi's affirmance of Statewide Rule 48 of the State Oil and Gas Board of Mississippi. [1] Although the Statement of the The Case as presented by Appellants is substantially accurate in all respects, certain salient facts should be emphasized. The two fields in question; Greens Creek Field and East Morgantown Field, are two separately defined natural gas fields in Marion County, Mississippi. Each

---

1 Rule 48 reads as follows:

> "Each person now hereafter engaged in the business of purchasing oil or gas from owners, grerators or producers shall purchase without discrimination in favor of one owner, grerator or producer against another in the same common source of supply."

field produces from the Harper Sand Gas pool and they are contiguous. One well, theoretically, could drain the entire pool. This would be true whatever allowable production was permitted; the only factor would be the length of time it would take to drain the pool. The State Oil and Gas Board of Mississippi has sought to prevent by Statewide Rule 48 and its order in the instant matter the inequitable drainage of the field and to protect the coequal and correlative equal rights of the owners of the natural gas. The Board's order does not establish what part of the allowable Transco must take, but if Transco takes, it must take ratably among the owners; that is if Transco takes seventy percent (70%) of the allowable, that seventy percent (70%) must be divided among all owners in the well on a proportionate basis. In addition, the record is clear that Transco was free to re-negotiate the

contracts and had re-negotiated some of its contracts, with the owners and/or grerators.

The final result is that by its action Transco was taking gas in non-uniform, disproportionate and unratable rates from the common pool causing undue drainage and thereby permitting one or more owners in the pool to produce more than their just and equitable share of the production from the pool.

ARGUMENT

I.

THERE ARE NO SUBSTANTIAL FEDERAL QUESTIONS

1. The Appellants place undue reliance on Northern Natural Gas Co. v. State Corporation Commission of the State of Kansas, 372 U.S. 84, 9 L.Ed.2d 601, 83 S.Ct. 646 (1963).

Although initially the facts in that case seem identical to the facts in the case sub judice, there are easily distinguishable differences. In Northern, the gas pipe line company was connected to 1100 natural gas wells in one field. Here, Transco is connected to all six (6) wells in two (2) fields draining a common pool. There were 125 contracts in Northern and six (6) here. In Northern the contracts were filed with the Federal Power Commission. Here they are not filed with any federal regulatory agency. Under the oldest contract, Northern was obligated to purchase gas up to the maximum production allowable from the operators wells connected to the pipe line. Here the contracts have been re-negotiated and there was no such requirement. Northern's other contracts with other producers provided that Northern's purchase commitment with them was subject to the agreement with Republic. (Northern only had to purchase from these producers only so much of

its requirements as were not satisfied by the quantities which it was required to take from the Republic wells.)

Northern, until 1958, purchased from the producers other than Republic, on a roughly ratable basis that is in like proportion to the legally fixed allowables for each of the 1100 wells in the field. After 1958, Northern's requirements became substantially less than that of the total allowables for all of the wells in the field. - [It appears that Northern had a contract for each well in the field to take 100% of the allowable.] Footnote 4 at p. 405. The decrease in the purchase was because:

> 1. The rate of increase in the allowables from the wells from which Northern was taking exceeded the increase in their requirements from the field.
>
> 2. Northern's expected expansion of its system had been delayed by the failure to secure the requisite Certificate of Convenience and Necessity from the FPC.

Thus, the balance of the total requirements after the contractual required purchases from Republic of the maximum allowables for Republics wells resulted in the purchase from the other producers substantially below the allowables for their wells.

The Kansas Commission's order provided that Northern was to take gas from Republic wells in no higher proportion to the allowables than from the wells of the other producers. The Commission entered an order directing Northern to purchase gas ratably from all 1100 wells in the field. That is one hundred percent (100%) the allowables. This presented Northern with the problem of complying with its contractual obligations with Republic and also increasing its takes from the other producers' wells - thus taking more gas from Kansas than it could currently use. Here there is no order to take 100% of the allowables.

The case was decided on the bases of the construction of the Natural Gas Act and not constitutional questions. Footnote 10, at p. 607. Of particular import is the fact that Northern addresses the primary purpose of the National Gas Act; that is to protect consumers against exploitation at the hands of the natural gas companies. Federal Power Commission v. Transco, 365 U.S. 1, 5 L.Ed.2d 377, 81 S.Ct. 435 (1961). Therefore, the reasoning and holding in Northern is not controlling in the instant matter since Statewide Rule 48 has no direct or indirect interference with prices of natural gas wholesale in Interstate Commerce and is therefore no threat to a comprehensive scheme of Federal regulation. Further, Transco is not required to take all or any portion of the allowables for any well. However, if they do take, they must take ratably.

What has happened is that Transco has not been astute enough in its contractual obligations and now wants out of them under the guise of an attack on Statewide Rule 48. Of course as market demand increases Transco will in all likelihood be back asking to take all of the gas that can be produced from the fields in question and voluntarily ratably take the production.

Consumer gas prices have continued to increase despite an over supply of gas on the market and because of the "take or pay provisions" [2] the companies put into their contracts and are expected to continue to rise through 1985. Jurisdictional Statement at p. 17. Certainly, this is not because of ratable

---

[2] Under the "take or pay provisions", of course, Transco makes its payment, it is entitled to the gas at a later time for no additional payments.

take rules and orders such as the one under attack here; but because of "regulatory schemes designed to increase gas prices" and poor anticipation in the negotiations of contracts.

2. A review of the Natural Gas Policy Act [3] and the Acts of the Federal Energy Regulatory Commission since the passage thereof together with Statewide Rule 48 reveals no conflict. The State Oil and Gas Board is not attempting to regulate what Congress said should be unregulated; the price paid for the first sale of such gas. Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, _____ U.S. _____, 103 S.Ct. 1905, 1912, 76L.Ed.2d 1, 10. The decision of the Supreme

---

[3] 15 U.S.C. §§ 3301 et seq.

Court of Mississippi is clear in that regard. Jurisdictional Statement, pp. 482-552.

II.

STATEWIDE RULE 48 DOES NOT CONSTITUTE AN IMPERMISSIBLE BURDEN ON INTERSTATE COMMERCE

There is no state statute or regulation adopted by any State of the Union that does not in some way effect interstate commerce. The question then arises as to whether the state statute or regulations effect is so de minimus as to purpose a constitutionally impermissible burden thereon. The general rule is:

> ". . . where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in

> relation to the putative local benefits. Huron Cement Co. v. Detro, 362 U.S. 440, 443, 4 L.Ed.2d 852, 856, 80 S.Ct. 813. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with lesser impact on interstate commerce.
>
> Pike v. Bruce Church, Inc., 397 U.S. 137, 142, 25 L.Ed.2d 174, 178-179, 90 S.Ct. 844, 847.

There is no undue burden on interstate commerce as a result of Statewide Rule 48. The fact that the ultimate consumer of the gas may be paying more is not the result of this rule but because ". . . a regulatory scheme designed to increase gas prices." Jurisdictional Statement, p. 16.

The local interest herein involved is that of protecting the rights of the mineral owners. After all, if the State does not protect the rights of the mineral owners who will? The Federal Energy Regulatory Commission

has not adopted, nor to these Appellees knowledge, proposed the adoption, of any rules which would protect these interests and assure equity and fairness between the various interests of minerals being depleted from a common source or pool, which Rule 48 is designed to protect. There is no room for doubt that states possess the power to allocate and conserve scare natural resources beneath their lands. Northern, supra; Patterson v. Standolina Oil and Gas Co., 305 U.S. 376, 83 L.Ed.2d 231, 59 S.Ct. 259; Bandini Petroleum Co. v. Superior Court, 284 U.S. 8, 76 L.Ed. 136, 52 S.Ct. 103; Walls v. Midland Carbon Co., 254 U.S. 300, 65 L.Ed. 276, 41 S.Ct. 118. This is true whomever the owner may be or wherever he may reside and it is applied "even-handedly". Transco's argument in regard to Commerce Clause implications simply do not meet the test as set

out in Pike, supra. The Appellants have no standing to maintain this action.

Section 601(c) of the Natural Gas Policy Act permits Transco to pass through any costs, (which Appellees denies there will be any increase because of the application of Rule 48) with certain restrictions. Appellees submit that a serious question is presented as to whether Transco has any standing to raise a Commerce Clause violation in connection with Rule 48.

Article III of the Constitution confines federal courts to adjudicating "cases" and "controversies" and requires the litigant to have standing to allege a personal injury fairly traceable to the defendants allegedly unlawful conduct which will likely be redressed by the relief requested. Valley Forge Christian

College v. Americans United for Separation of Church and State, 422 U.S. 490, 70 L.Ed.2d 700, 102 S.Ct. 752 (1982).

Here if the costs increase because of Rule 48, which these Appellees do not admit, then Transco can pass the cost through to the consumer. Therefore, what distinct and palpable injury has the Appellant suffered that is not abstract, conjectural or hypothetical? Valley Forge, supra. The answer is none. Transco freely and voluntarily entered into the contracts with the idea of making money, and while that has not proven to be true according to Transco, Rule 48 is certainly not the reason. Transco never questioned the ratable take requirement before market conditions changed and in fact took ratably. Now, since market conditions changed they do not wish to take ratably but wish to attack Rule 48 in order to fight

off competition. This is certainly not a Commerce Clause claim to be adjudicated by the Court.

CONCLUSION

When the non-issues are put aside and the true facts are examined, the end result is that Transco failed to anticipate the change in the market for natural gas and actions of competitors and now seeks this Court to note probable jurisdiction with unsubstantial federal questions, and a commerce clause claim couched in language that requests relief in terms that normally confer jurisdiction, in order that it may be relieved of the necessity of complying with unfavorable contract terms and thereby drain and waste the resources of some of the owners of the common pool in a non-uniform, disproportionate, unequitable and unratable

manner. The Court should not note probable jurisdiction and Transco's appeal should be dismissed or in the alternative the decision of the Mississippi Supreme Court should be affirmed.

Respectfully submitted,

EDWIN LLOYD PITTMAN, ATTORNEY GENERAL
STATE OF MISSISSIPPI

R. LLOYD ARNOLD
SPECIAL ASSISTANT ATTORNEY GENERAL

ED DAVIS NOBLE, JR.
ASSISTANT ATTORNEY GENERAL
COUNSEL OF RECORD

BY: Ed Davis Noble, Jr.
ED DAVIS NOBLE, JR.

Office of the Attorney General
Post Office Box 220
Jackson, Mississippi 39205
Telephone: (601) 359-3680

CERTIFICATE OF SERVICE

I, Ed Davis Noble, Jr., an Assistant Attorney General for the State of Mississippi, do hereby certify that I have this day caused to be mailed, via United States Postal Service, first-class postage prepaid, three (3) true and correct copies of the foregoing Brief in Support of Motion to Dismiss, or in the Alternative to Affirm the Decision of the Supreme Court of Mississippi to the following:

John Marshall Grower, Esquire
BRUNINI, GRANTHAN, GROWER & HEWES
Attorneys at Law
Post Office Drawer 119
Jackson, Mississippi 39205

R. V. Loftin, Jr., Esquire
Attorney at Law
Post Office Box 1396
Houston, Texas 77251

Frederick Moring, Esquire
CROWELL & MORING
Attorneys at Law
1100 Connecticut Avenue, N.W.
Washington, D. C. 20036

Honorable Rex E. Lee
Solicitor General
Department of Justice
Washington, D. C. 20530

Glenn Gate, Taylor, Esquire
HEIDELBERG, WOODLIFF & FRANKS
Attorneys at Law
Suite 1030 Capitol Towers
Jackson, Mississippi 39201

Walker L. Watters, Esquire
GERALD, BRAND, WATTERS, COX &
HEMLEBEN
Attorneys at Law
400 Lamar Life Building
Jackson, Mississippi 39201

John Land McDavid, Esquire
McDAVID, EDMONSON & NOBLIN
Attorneys at Law
8th Floor, City Center North
210 S. Lamar Street
Jackson, Mississippi 39201

William L. Waller, Esquire
WALLER & WALLER
Attorneys at Law
475 East Capitol Street
Jackson, Mississippi 39201

Vernon L. Terrell, Jr., Esquire
PLAUCHE', HARTLEY, LaPEYRE & OTTINGER
Attorneys at Law
Suite 3618 One Shell Square
New Orleans, Louisiana 70139

This, the 27th day of February, 1985.

Ed Davis Noble, Jr.
ED DAVIS NOBLE, JR.

Office - Supreme Court, U.S.
FILED
MAR 18 1985
ALEXANDER L. STEVAS
CLERK

No. 84-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

VS.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

REPLY FOR APPELLANT

JOHN MARSHALL GROWER
(Counsel of Record)
JEFFERSON D. STEWART
R. WILSON MONTJOY, II
BRUNINI, GRANTHAM, GROWER & HEWES
1400 First National Bank Building
Post Office Drawer 119
Jackson, Mississippi 39205
Telephone: (601) 948-3101

R. V. LOFTIN, JR.
THOMAS E. SKAINS
DAVID A. GLENN
TRANSCONTINENTAL GAS PIPE LINE CORPORATIION
Attorneys for Appellant

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

TABLE OF CONTENTS

	Page
ARGUMENT	1
CONCLUSION	6

TABLE OF AUTHORITIES

CASES	Page
Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, 461 U.S. 375 (1983	3
Cities Service Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179 (1950)	2
Exxon Corp. v. Eagerton, 103 S. Ct. 2296 (1983)	5
Maryland v. Louisiana, 451 U.S. 725 (1981)	5
Northern Natural Gas Co. v. State Corporation Commission, 372 U.S. 84 (1963)	2, 5
Warth v. Seldin, 422 U.S. 490 (1975)	5
STATUTES	
15 U.S.C. § 3431(c)(2)	2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

VS.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

REPLY FOR APPELLANT

This brief is submitted by Transcontinental Gas Pipe Line Corporation (Transco) to a limited number of the points raised in the Motions to Dismiss filed by the State of Mississippi, Getty Oil Company and Coastal Exploration, Inc. Since the majority of the points raised by Appellees have been addressed in Transco's Jurisdictional Statement and in the briefs filed by amici curiae, the United States of America and the Associated Gas Distributors, further response will not be made herein.

1. Appellees have argued that this Court should return to its approval of ratable take regulations in *Cities Service Gas Company v. Peerless Oil & Gas Company*, 340 U.S. 179 (1950) (hereinafter cited as *Peerless*). This position is incorrect.

In *Peerless*, this Court expressly noted that the issue of preemption, *i.e.*, possible interference with the federal regulatory scheme under the Natural Gas Act, had been neither raised nor decided, 340 U.S. at 188-89. *Peerless* is not a preemption case and therefore cannot support Appellees' position on the Supremacy Clause. This Court has never approved state ratable take regulations where a preemption challenge has been made. In fact, the only case which has considered state ratable take regulations in light of the Natural Gas Act was *Northern Natural Gas Co. v. State Corporation Commission*, 372 U.S. 84 (1963). Contrary to representations by Appellees, *Northern Natural* did not approve *Peerless*—it distinguished Peerless on the ground that the issues in the two cases were unrelated. *Id.* at 91, n. 10.

2. Appellees have asserted that the "deregulation" of the first sale of certain categories of natural gas under the NGPA was not only a withdrawal of FERC jurisdiction but also an open invitation for the substitution of a state regulatory scheme. This is incorrect in several respects. First, FERC has retained jurisdiction over interstate pipelines, their transportation of gas and their resales. For example, the "guaranteed" pass through for deregulated gas is still subject to FERC review and rejection based upon fraud, abuse or similar grounds, 15 U.S.C. Section 3431(c)(2). Therefore, federal domination of this field is still so complete that it precludes state regulation.

Second, state regulations which cause increased consumer gas prices are contrary to Congressional intent. One critical problem addressed by the NGPA was that earlier government control of wellhead prices had made those prices unresponsive to market conditions. Federal price controls had undervalued natural gas, creating high demand but discouraging adequate exploration. By "deregulating" prices, Congress did effect a limited withdrawal of FERC jurisdiction. The Congress recognized that an increase in consumer prices was a necessary evil in order to encourage production of adequate supplies. By eliminating federal control of wellhead prices, it was hoped to make those prices more responsive to the market.

Congress never anticipated that the production incentives of the NGPA would ultimately result in a severe oversupply of gas at above-market prices. However, it is completely inconsistent with the purpose of the NGPA to allow the states to enact regulations which have the practical effect of further increasing the price of gas to the interstate consumer. Federal "deregulation" of the price paid for the first sale of certain categories of natural gas was an indication that the price should remain unregulated and free to rise and fall with market conditions. *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375, 383-84 (1983). Deregulation was not an invitation to the states to re-regulate and thereby affect the price of gas.

3. Appellees also claim that there is no significant interstate impact of Rule 48 because the only adverse result is the imposition of take or pay obligations which can be "made up" by additional pipeline takes in later years. However, the impact is much broader. Appellees have generally ignored the "practical effects" of Rule 48. They have ignored the interstate burdens caused by forcing pipelines to purchase

more gas in Mississippi than from other states. They have likewise ignored the fact that ratable take regulations, if constitutional, can be expected to be enforced throughout Mississippi and in other states, resulting in a dramatic and adverse impact on the consumer. Finally, Appellees have ignored the consumer price increases resulting from taking additional quantities of deregulated gas, even at market value, in lieu of much older gas supplies which bear a contract price significantly lower than the current market value.

Appellees are likewise incorrect in their assertion that the impact of take-or-pay obligations does not create a Commerce Clause violation. Appellees disregard the increased price to consumers resulting from take-or-pay payments even if the gas is ultimately made up. Transco's only "profit" is the federally regulated rate of return it is given an opportunity to earn on its capital investment. Thus, the cost of take-or-pay, like the cost of higher gas prices, will be borne by the consumer through higher pipeline resale rates, thereby creating a Commerce Clause violation.

Further, the very existence of ratable take regulations helps assure that make-up will be an illusory remedy. Higher purchased gas costs and take-or-pay obligations increase the price of gas to the consumer, thereby further reducing market demand. As market demand decreases, less gas is sold, and more take-or-pay obligations are incurred. The date at which there is sufficient demand to make up gas is therefore delayed until after depletion of many wells and the expiration of contract make-up rights, rendering make-up impossible.

4. The State of Mississippi has asserted that Transco does not have standing to challenge Rule 48. A standing challenge is properly directed to a plaintiff in the federal

courts. *See, e.g., Warth v. Seldin*, 422 U.S. 490 (1975). The concept is simply inapplicable to a defendant like Transco, which merely defended itself against the application of an unconstitutional regulation and has appealed an adverse decision through the state courts to this forum.

5. Finally, Appellees have erroneously portrayed *Northern Natural* as based solely upon federal regulation of wellhead prices. *Northern Natural* was not concerned with wellhead prices; rather it dealt with ratable take regulations which indirectly conflicted with the federal regulation of pipelines and their transportation and resales of gas. 372 U.S. at 90-93. Federal jurisdiction over these areas remains even after the NGPA. *Exxon Corp. v. Eagerton*, 103 S. Ct. 2296, 2302-4 (1983); *Maryland v. Louisiana*, 451 U.S. 725, 749-52 (1981). Therefore, if there is to be regulation, it must come from the federal government. Just as in *Northern Natural*, state ratable take regulations intrude into an area reserved for the federal government and are therefore preempted.

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted,

JOHN MARSHALL GROWER
(Counsel of Record)
JEFFERSON D. STEWART
R. WILSON MONTJOY, II
BRUNINI, GRANTHAM, GROWER
& HEWES

R. V. LOFTIN, JR.
THOMAS E. SKAINS
DAVID A. GLEEN
TRANSCONTINENTAL GAS PIPE
LINE CORPORATION
Attorneys for Appellant

Office-Supreme Court, U.S.
FILED
JAN 31 1985
ALEXANDER L. STEVAS,
CLERK

No. 84-1076

In the Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
APPELLANT
v.
THE STATE OIL & GAS BOARD OF MISSISSIPPI
AND COASTAL EXPLORATION, INC., ET AL.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF MISSISSIPPI

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICUS CURIAE

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

WILLIAM H. SATTERFIELD
General Counsel

JEROME M. FEIT
Solicitor

JOSEPH S. DAVIES
LESLIE LAWNER
Attorneys
Federal Energy Regulatory Commission
Washington, D.C. 20426

QUESTION PRESENTED

Whether the ruling of the Mississippi Supreme Court that an interstate pipeline is required to purchase gas at a uniform percentage from all owners in a common pool of gas constitutes forbidden state regulation, when the ultimate consequence of the requirement will be to increase rates charged the ultimate consumers of gas in other states.

TABLE OF CONTENTS

Page

Interest of the United States 1

Statement 2

Discussion 6

Conclusion 13

TABLE OF AUTHORITIES

Cases:

American Paper Institute, Inc. v. *American Electric Power Service Corp.*, 461 U.S. 402 ... 11

Arkansas Electric Cooperative Corp. v. *Arkansas Public Service Comm'n*, 461 U.S. 375 10

Arkansas Louisiana Gas Co. v. *Hall*, 453 U.S. 571 12

Atlantic Refining Co. v. *Public Service Comm'n*, 360 U.S. 378 2

Cities Service Gas Co. v. *State Corp. Comm'n*, 355 U.S. 391 12

City of Philadelphia v. *New Jersey*, 437 U.S. 617 12

Clark v. *Uebersee Finanz-Korporation, A.G.*, 332 U.S. 480 11

Columbia Gas Development Corp. v. *FERC*, 651 F.2d 1146 10

Energy Reserves Group, Inc. v. *Kansas Power & Light Co.*, 459 U.S. 400 11

Exxon Corp. v. *Eagerton*, 462 U.S. 176 ..... 8, 10, 11

Page

Cases—Continued:

Hines v. *Davidowitz*, 312 U.S. 52 8

Maryland v. *Louisiana*, 451 U.S. 725 ..... 8, 12

Northern Natural Gas Co. v. *State Corp. Comm'n*, 372 U.S. 584 ..... 2, 5, 6, 7, 8, 10, 12

Phillips Petroleum Co. v. *Wisconsin*, 347 U.S. 672 ..... 8, 9

Pike v. *Bruce Church, Inc.*, 397 U.S. 137 12

Public Service Comm'n v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 10

Transcontinental Gas Pipe Line Corp. v. *State Oil & Gas Board*, Civil Action No. J82-0531(L) (S.D. Miss. filed Oct. 13, 1982) 2

Constitution, statutes and regulations:

U.S. Const. Art. I, § 8, Cl. 13 (Commerce Clause) 6

Department of Energy Organization Act § 402(a)(1), 42 U.S.C. 7172(a)(1) 1

Natural Gas Act, 15 U.S.C. 717 *et seq.* 1, 2

§ 2(6), 15 U.S.C. 717a(6) 8

§ 4, 15 U.S.C. 717c 1

§ 5, 15 U.S.C. 717d 1

§ 7, 15 U.S.C. 717f 9

§ 7(b), 15 U.S.C. 717f(b) 9

§ 7(c), 15 U.S.C. 717f(c) 9

Page

Constitution, statutes and regulations—Continued:

Natural Gas Policy Act of 1978, 15 U.S.C. 3301 *et seq.* 1

§ 107, 15 U.S.C. 3317 ..... 3, 9, 10, 11

§ 107(c)(1), 15 U.S.C. 3317(c)(1) 3

§ 121(b), 15 U.S.C. 3331(b) 3

§ 315, 15 U.S.C. 3375 9

§ 501(a), 15 U.S.C. 3411(a) 1

§ 504, 15 U.S.C. 3414 2

§ 504(b)(1), 15 U.S.C. 3414(b)(1) 1

§ 601, 15 U.S.C. 3431 4

§ 601(a), 15 U.S.C. 3431(a) 5, 8, 9, 10, 11

§ 601(c)(2), 15 U.S.C. 3431(c)(2) 2

§ 602(a), 15 U.S.C. 3432(a) 11

Miss. Code Ann. § 53-1-1 (1972) 3, 5

Miscellaneous:

124 Cong. Rec. 28633 (1978) 11

H.R. 8444, 95th Cong., 1st Sess. (1977) 9

H.R. Conf. Rep. 95-1752, 95th Cong., 2d Sess. (1978) 11

H.R. Rep. 95-496, 95th Cong., 1st Sess. Pt. 4 (1977) 8

S. Rep. 95-436, 95th Cong., 1st Sess. (1977) 8

In the Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
APPELLANT

v.

THE STATE OIL & GAS BOARD OF MISSISSIPPI
AND COASTAL EXPLORATION, INC., ET AL.

ON APPEAL FROM THE SUPREME COURT
OF THE STATE OF MISSISSIPPI

BRIEF FOR THE UNITED STATES AND
THE FEDERAL ENERGY REGULATORY COMMISSION
AS AMICUS CURIAE

INTEREST OF THE UNITED STATES

Congress has charged the Federal Energy Regulatory Commission with the responsibility of administering the Natural Gas Act, 15 U.S.C. 717 *et seq.*, and the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq.* See Section 402(a)(1) of the Department of Energy Organization Act, 42 U.S.C. 7172(a)(1), and Sections 501(a) and 504(b)(1) of the NGPA, 15 U.S.C. 3411(a) and 3414(b)(1).

Under the Natural Gas Act, the Commission is responsible for establishing the resale rates for natural gas at "just and reasonable" levels (Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. 717c, 717d). Under the NGPA the Commission is responsible for enforcing maximum lawful prices for

wellhead sales of natural gas established by Congress (Section 504 of the NGPA, 15 U.S.C. 3414), and for preventing interstate pipelines like appellant from passing through to their consumers the cost of gas they purchase to the extent such cost is excessive due to "fraud, abuse, or similar grounds" (Section 601(c)(2) of the NGPA, 15 U.S.C. 3431(c)(2)). In all cases, the Commission must assure that the public has an adequate supply of natural gas in the interstate market "at the lowest possible reasonable rate consistent with the maintenance of adequate service." *Atlantic Refining Co.* v. *Public Service Comm'n*, 360 U.S. 378, 388 (1959). The state scheme upheld here interferes significantly with the discharge of these responsibilities. Cf. *Northern Natural Gas Co.* v. *State Corp. Comm'n (Northern Natural)*, 372 U.S. 584 (1963).[1]

STATEMENT

1. Appellant, Transcontinental Gas Pipe Line Corporation (Transco), is an interstate pipeline engaged in the transportation and sale for resale of natural gas in interstate commerce, subject to the Natural Gas Act, 15 U.S.C. 717 *et seq.* Until the summer of 1982, appellant had purchased gas at a uniform rate (ratably), regardless of whether it had a contract with the selling interest-owner or not, from wells producing gas from a common pool beneath the Greens Creek and East Morgantown Fields in Marion County,

---

[1]Although the Commission did not participate in these state court proceedings, it did intervene in a parallel proceeding brought by appellant in federal district court seeking a declaratory order and injunctive relief against the order of the State Oil and Gas Board. *Transcontinental Gas Pipe Line Corp.* v. *State Oil & Gas Board*, Civil Action No. J82-0531(L) (S. D. Miss. filed Oct. 13, 1982). The district court has not issued any final decision in that case. On December 7, 1984, Coastal Exploration, Inc., moved to dismiss the suit on the ground that the decision of the Mississippi Supreme Court in the instant case res judicata or collateral estoppel effect should be accorded.

BEST AVAILABLE COPY

Mississippi. Appellant's contracts with some of the interest-owners contained "take-or-pay" clauses (J.S. 4).[2] The gas in this common pool was all "high-cost natural gas" (or Section 107 gas) not subject to price control (15 U.S.C. 3317, 3331(b)).[3] In the spring of 1982, appellant began to experience problems selling this high cost gas to its interstate system-supply customers because end-use industrial customers were switching from gas to cheaper fuel oil (J.S. 6). As a result, in May 1982, appellant announced it would no longer take or purchase gas from the owners and producers with whom it did not have gas purchase contracts. *Ibid.*

Coastal Exploration, Inc., and other non-contract working interest owners thereupon petitioned the Mississippi Oil and Gas Board to enforce its Rule 48 (a ratable take rule),[4] by requiring appellant to purchase gas ratably from all the producers, even those with which appellant had no contracts. Appellant argued that the Board should, instead, reduce the "allowables" for the reservoir—*i.e.*, the maximum permissible production[5] — to reflect market demand

---

[2]A "take-or-pay" clause in a gas contract requires the purchaser to pay for a specified volume of gas which the producer-seller has available for delivery, regardless of whether the purchaser takes the gas or not. Under such a clause the purchaser usually has the right to take the gas paid for (but undelivered) in succeeding years.

[3]Section 107(c)(1) of the Natural Gas Policy Act (NGPA), 15 U.S.C. 3317(c)(1), defines "high-cost natural gas" as gas produced from wells begun after February 1977 at completion locations deeper than 15,000 feet. Under Section 121(b) of the NGPA, 15 U.S.C. 3331(b), the "first sale" (*i.e.*, field or wellhead) price of such gas is not subject to price controls.

[4]That rule provides (J.S. 7):

> Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, or producers shall purchase without discrimination in favor of one owner, operator, or producer against another in the same common source of supply.

[5]In Mississippi the allowables for gas reservoirs are established at the maximum amount of gas a reservoir is capable of producing. See Miss. Code Ann. § 53-1-1 (1972), n.6, *infra*.

or, alternatively, should allocate ratably to all producers the volumes appellant was obliged by contract to purchase. The Board rejected these alternatives. Instead, it granted the producers' petition, requiring appellant to purchase the reservoir's full allowables ratably from all producers (J.S. App. 104a-113a). The Board also ruled that appellant must purchase all such gas—even the volumes of gas that it had not contracted to purchase—under non-discriminatory price and take-or-pay conditions (*id.* at 112a).

2. On June 28, 1983, the Mississippi State Circuit Court for the First Judicial District of Hinds County affirmed the Board's order (J.S. App. 59a-103a). That court found that the order did not violate this Court's decision in *Northern Natural* or invade the Commission's regulatory authority because, in the court's view, Section 601 of the NGPA (15 U.S.C. 3431) had eliminated Commission jurisdiction over wellhead sales, thereby creating a vacuum into which the states could step. In the words of the circuit court (J.S. App. 73a-74a):

> Under the Section 601 statutory scheme, Section 601(a)(1) removes FERC's NGA-jurisdiction to directly or indirectly control or regulate a pipeline's purchase of Section 107 gas and the price paid by the pipeline for that gas. In place of that "lost" jurisdiction over the pipeline's purchases of that gas, Section 601(c) gives FERC the jurisdiction and power to deny a pipeline a pass-through of the price the pipeline pays for 107 gas, but *only* if FERC can prove that the price results from "fraud, abuse or similar grounds." Moreover, FERC's power to deny the pipeline a pass-through can be exercised *only* against the pipeline and only when (and if) the pipeline comes before FERC to obtain authority to pass-through the entire price paid by the pipeline and include that price in the resale rates charged by the

> pipeline to consumers. However, FERC still has no authority or jurisdiction (not even under Section 601(c)) to regulate or control a pipeline's purchase of 107 gas, or the price the pipeline pays to producers or the pipeline's contract with the producers.

The court also observed (J.S. App. 87a) that the Mississippi Code, Miss. Code Ann. § 53-1-1 (1972), specifically prohibits the Board from prorating the production from the reservoir according to market demand, as appellant had suggested.[6]

3. On September 5, 1984, the Mississippi Supreme Court reversed the Board's order to the extent it proscribed differences in wellhead prices, because, in the court's view, the Mississippi legislature had not authorized the Board to set prices for gas at the wellhead (J.S. App. 48a-55a). The court affirmed in all other respects. It agreed with the circuit court that Section 601(a) of the NGPA had removed any impediment to state regulation posed by this Court's decision in *Northern Natural* or by the Natural Gas Act (J.S. App. 23a-29a) and that the Board had properly ordered appellant to take the full allowables ratably from all wells (J.S. App. 57a). In the words of the Mississippi Supreme Court, "[h]owever consistent a continued proscription on state regulation might have been with the theoretical

---

[6]Section 53-1-1 of the Mississippi Code states (J.S. App. 87a):

> It is not the intent nor the purpose of this law to require or permit the proration or distribution of the production of oil and gas among the fields and pools of Mississippi, on the basis of market demand. It is the intent and purpose of this law to permit each and every oil and gas pool in Mississippi to be produced up to its maximum efficient rate of production, subject to the prohibition of waste as herein defined, and subject further to the enforcement and protection of the co-equal and correlative rights of the owners of a common source of oil and gas, so that each common owner may obtain his just and equitable share of production therefrom.

underpinnings of deregulation, the Congress in [the] NGPA * * * did not ban state regulation of deregulated gas." J.S. App. 29(a).

DISCUSSION

This case presents an important question concerning the scope of permissible state authority to affect resale of gas in interstate commerce within the scheme of federal regulation established by the Natural Gas Act and the NGPA. At the center of the controversy is the question of the continuing validity of this Court's decision in *Northern Natural.* There is also the discrete question whether the state scheme of regulation at issue affects interstate commerce in a way forbidden by the Commerce Clause of the United States Constitution. Both issues implicate broad concerns touching on national energy policy and warrant review by this Court.

I.

A. The Mississippi Board's order directing appellant to take gas ratably from all wells in the common pool constitutes an impermissible effort to exert leverage upon an interstate pipeline company to increase its purchases of high-cost (*i.e.,* deregulated) gas from Mississippi wells. Because take-or-pay provisions in appellant's contracts remain in effect, appellant is faced with a Hobson's choice. Its first option is to increase its purchases of the high-cost gas from all wells in the common pool to the highest level at which it is contractually required to purchase from any single interest-owner, and make corresponding reductions elsewhere, thereby burdening its interstate customers with high-cost gas when there is already a glut of high priced gas in the interstate market. Appellant's other option is no more attractive: it can reduce the volume of its purchases from the interest-owners with whom it has contracts, and limit its purchases from the other interest-owners in the pool to like

percentages, thereby incurring take-or-pay liability for the volumes it fails to take under its contracts and similarly burdening its interstate customers with these added costs. The decision below thus imposes significant burdens on appellant's customers, and ultimately on the entire gas market.[7]

In *Northern Natural* this Court set aside quite similar orders requiring ratable takes from Kansas wells on the ground that the "orders necessarily deal with matters which directly affect the ability of the Federal Power Commission [now FERC] to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act." 372 U.S. at 91-92. This Court explained (*id.* at 92) that:

> [t]he danger of interference with the federal regulatory scheme arises because these orders are unmistakably and unambiguously directed at *purchasers* who take gas in Kansas for resale after transportation in interstate commerce * * *. Moreover, any readjustment of purchasing patterns which such orders might require of purchasers who previously took unratably could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States.

---

[7]Take-or-pay contract clauses are common in natural gas contracts (J.S. 4 n.3), and states have frequently adopted ratable take requirements. See *Northern Natural,* 372 U.S. at 101 n.3 (Harlan, J., dissenting), noting that "[m]ost of the more important oil and gas producing States have long had statutes providing for ratable taking by *purchasers"* (emphasis in original). Thus, unless this Court reverses the decision below, many other pipelines are likely to be faced with appellant's dilemma with a resulting significant increase in prices throughout the gas market.

Accordingly, this Court invalidated the Kansas orders as "invad[ing] the federal agency's exclusive domain." *Ibid.*

In *Maryland* v. *Louisiana,* 451 U.S. 725, 751 (1981), this Court reaffirmed its holding in *Northern Natural* in invalidating a state statute that "interfere[d] with the FERC's authority to regulate the determination of the proper allocation of costs associated with the sale of natural gas to consumers." 451 U.S. at 749. There too, this Court held that the state statute was preempted by the Natural Gas Act because it effectively "shift[ed] the incidence of certain expenses * * * to the ultimate consumer of the processed gas without the prior approval of the FERC" (451 U.S. at 750); see also *Exxon Corp.* v. *Eagerton,* 462 U.S. 176, 185 (1983). Since the order of the Mississippi Board in the instant case has the same effect, it too "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" (*Hines* v. *Davidowitz,* 312 U.S. 52, 67 (1941)) in this field and "must give way" to the federal scheme. *Maryland* v. *Louisiana,* 451 U.S. at 751; *Exxon Corp.* v. *Eagerton, supra.*

B. Contrary to the view of the courts below, Section 601(a) of the NGPA, 15 U.S.C. 3431(a), did not undermine *Northern Natural,* or the principles there articulated. The NGPA did not open a gap for state regulation of the price of deregulated gas.

1. The NGPA was enacted in large measure to eliminate the bifurcated pricing system between the interstate and intrastate markets for sale of gas engendered by the decision in *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672 (1954), that independent producers selling gas for resale in the interstate market were "natural-gas companies" under Section 2(6) of the Natural Gas Act, 15 U.S.C. 717a(6). See *e. g.,* S. Rep. 95-436, 95th Cong., 1st. Sess. 7-9 (1977); H.R. Rep. 95-496, 95th Cong., 1st Sess. Pt. 4, at 89-90 (1977);

See also H.R. 8444, 95th Cong., 1st Sess. § 2 (1977) (Findings and Statement of Purposes).[8] The NGPA met the *Phillips* problem in two ways. First, in Title I of the NGPA, "Wellhead Pricing," Congress created a comprehensive set of tiered "maximum lawful" (*i.e.*, ceiling) prices applicable to all "first sales" (*i.e.*, field or wellhead sales) for both the interstate and intrastate markets, with certain categories of gas, like the deregulated Section 107 gas at issue here, freed from price controls altogether. Second, in Section 601(a) of the NGPA (15 U.S.C. 3431(a)) entitled "Coordination With The Natural Gas Act," Congress provided that the Commission's jurisdiction under the Natural Gas Act should not apply "solely by reason of any first sale" of such deregulated gas. The manifest purpose of Section 601(a) was to exclude the first sale by independent producers of certain gas, like deregulated Section 107 gas, from the certification and tariff (wellhead pricing) authority of the Commission under the Natural Gas Act that had resulted from the decision in *Phillips Petroleum Co.* v. *Wisconsin, supra.*[9] There is not

---

[8]As a consequence of the decision in the *Phillips* case, independent producers of natural gas were required to obtain certificates of convenience and necessity from the Commission under Section 7(c) of the Natural Gas Act, 15 U.S.C. 717f(c), in order to sell their gas in interstate markets. Accordingly, producers filed their gas sales contracts with the Commission as part of their certificate applications, and the Commission then reviewed those contracts to insure that the contract prices for the sale of gas was not set at rates higher that those determined by the Commission to be "just and reasonable." In addition, under Section 7(b) of the Natural Gas Act, 15 U.S.C. 717f(b), producers were prohibited from abandoning those certificated sales without first obtaining Commission approval.

[9]This narrow purpose of Section 601(a) is confirmed by the cross-reference to its provisions in Section 315 of the NGPA, 15 U.S.C. 3375. Section 315 reserves certain limited authority to the Commission to deal with deregulated gas despite Section 601(a) by establishing minimum contract durations for first sales, a matter that would previously have been established pursuant to the Commission's certification authority under Section 7 of the Natural Gas Act, 15 U.S.C. 717f (see n. 8, *supra*). It also replaces Commission abandonment authority with self-

the slightest indication that Section 601(a) was intended to go further and abrogate the Commission's traditional Natural Gas Act responsiblility to regulate the relationship between a pipeline and its system customers, the responsibility implicated here and in this Court's decision in *Northern Natural.* See *Public Service Comm'n* v. *Mid-Louisiana Gas Co.,* 463 U.S. 319, 336-337 (1983); *Exxon Corp.* v. *Eagerton,* 462 U.S. at 184-186; *Northern Natural,* 372 U.S. at 92; *Columbia Gas Development Corp.* v. *FERC,* 651 F.2d 1146, 1149-1150 (5th Cir. 1981).

2. Nor is there any basis to conclude that the restriction on Commission jurisdiction imposed by Section 601(a) somehow opens the way for state regulation which is tantamount to price regulation at the wellhead.[10] Under Title I of the NGPA, Congress obviously occupied the field of wellhead pricing, establishing certain categories of deregulated gas, like Section 107 gas, to stimulate supplies that are truly at the limit of economic recovery by making them free from both federal and state price controls.[11]

---

implementing procedures requiring a seller desiring to abandon service to a buyer to make a bona fide offer to continue the sale of the gas to the buyer at or below the lawful maximum price and extending to the buyer a right of first refusal over any subsequent bona fide offer the seller receives. Thus, Section 601(a) is a part of a carefully limited restructuring of the Commission's authority in a new, integrated regulatory system; it does not simply create a gap in regulatory authority, to be filled in at the state's option.

[10]While the decision of the Mississippi Supreme Court set aside the Board's order to the extent it explicitly established a price for the sale of gas, the Board's order requiring purchase of decontrolled gas nonetheless has a price maintenance effect on appellant's customers. See pp. 6-7, *supra*; *Northern Natural,* 372 U.S. at 91-92.

[11]As this Court explained in *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Comm'n,* 461 U.S. 375, 384 (1983) (emphasis in original): "a federal decision to forgo regulation in a given area may imply an authoritative federal determination that the area is best left unregulated, and in that event would have as much pre-emptive force as a decision to regulate." The legislative history of the NGPA reflects just

BEST AVAILABLE COPY

Indeed, when Congress intended to allocate regulatory authority to the states in the NGPA, it clearly knew how to do so. In Section 602(a) of the Act, 15 U.S.C. 3432(a) Congress allowed states to impose price ceilings (less than the NGPA maximum price, but not higher) over first sales of gas, but only if the gas is produced and sold in *intrastate commerce*. See, H.R. Conf. Rep. 95-1752, 95th Cong., 2d Sess. 124-125 (1978). This Court has explained that under this provision the states are limited to establishing maximum prices for intrastate sales "in accordance with the overall national policy." *Energy Reserves Group, Inc.* v. *Kansas Power & Light Co.*, 459 U.S. 400, 421 (1983); *Exxon Corp.* v. *Eagerton*, 462 U.S. at 186-187.

In sum, the enactment of Section 601(a) provides no warrant for attributing to Congress the intent " 'to paralyze with one hand what it sought to promote with the other' " (*American Paper Institute, Inc.* v. *American Electric Power Service Corp.*, 461 U.S. 402, 421 (1983), quoting *Clark* v. *Uebersee Finanz-Korporation, A.G.*, 332 U.S. 480, 489 (1947)), by granting the states the regulatory authority here found to exist. Instead, reading Section 601(a) in light of its purpose and the comprehensive scheme of Title I of the NGPA, it is apparent that the Mississippi Board's order, which has the effect of regulating the price and volume of Mississippi gas passing into interstate commerce, conflicts with the NGPA and therefore must give way to that statutory scheme. *Maryland* v. *Louisiana, supra; Exxon Corp.* v. *Eagerton, supra.*

---

such a determination with regard to Section 107 gas. See 124 Cong. Rec. 28633 (1978) (remarks of Sen. Jackson in presenting conference report) ("Our objective was to target the revenues a producer can expect to receive from production from a given well. We wanted to elicit the maximum supply response at a minimum cost to consumers. For example, the most expensive kinds of wells to drill, those over 15,000 feet in depth, are deregulated * * * [because] they deserve the maximum economic incentive.").

II.

Even placing the federal statutory structure to one side, the Board's order is nonetheless flawed because it unduly burdens interstate commerce. While the state court decisions are based on the theory that the purpose of the challenged order is to ensure that one Mississippi producer is not discriminated against in favor of another producer in the same pool of natural gas, the inescapable impact of that order is far broader. It either forces additional volumes of high-cost natural gas into interstate channels, thereby increasing gas costs and gas volumes, or it imposes on consumers in other states increased rates due to appellant's contractual take-or-pay liability to Mississippi producers. In either case, the order has more than an "incidental effect" on appellants' interstate customers, and on producers in other states. See *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). Judged by its practical consequences, the order is plainly not a legitimate conservation measure, see *Northern Natural,* 372 U.S. at 93-94; instead, it reflects the very type of economic protectionism that has been uniformly outlawed as an impermissible burden on interstate commerce. See *Arkansas Louisiana Gas Co.* v. *Hall,* 453 U.S. 571, 580-582 (1981); *Maryland* v. *Louisiana,* 451 U.S. at 753-760; *City of Philadelphia* v. *New Jersey,* 437 U.S. 617 (1978). In short, the Board's order is a regulation of interstate commerce—one that stands on no better footing than the type of minimum price regulation this Court has already held invalid. *Cities Service Gas Co.* v. *State Corporation Comm'n,* 355 U.S. 391 (1958); *Northern Natural Gas Co.* v. *State Corp. Comm'n, supra.*

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted.

REX E. LEE
Solicitor General

WILLIAM H. SATTERFIELD
General Counsel

JEROME M. FEIT
Solicitor

JOSEPH S. DAVIES
LESLIE LAWNER
Attorneys
Federal Energy Regulatory Commission

JANUARY 1985

DOJ-1985-01

Office-Supreme Court, U.S.
FILED
FEB 4 1985
ALEXANDER L. STEVAS,
CLERK

(3)

No. 84-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

BRIEF AMICUS CURIAE OF ASSOCIATED GAS DISTRIBUTORS IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

FREDERICK MORING
Counsel of Record
M. LISANNE CROWLEY
CROWELL & MORING
1100 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 452-5800
Attorneys for Amicus Curiae Associated Gas Distributors

February 1, 1985

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

ASSOCIATED GAS DISTRIBUTORS
MEMBER COMPANIES

Atlanta Gas Light Co.
Baltimore Gas & Electric Co.
Bay State Gas Co.
The Berkshire Gas Co.
Boston Gas Co.
The Brooklyn Union Gas Co.
Central Hudson Gas & Electric Corp.
Chesapeake Utilities Corp.
City of Holyoke, Mass., Gas & Electric Dept.
City of Norwich, Dept. of Public Utilities
City of Westfield Gas & Electric Light Dept.
Colonial Gas Co.
Commonwealth Gas Co.
Concord Natural Gas Corp.
Consolidated Edison Company of New York, Inc.
Delmarva Power & Light Co.
Elizabethtown Gas Co.
EnergyNorth, Inc.
Essex County Gas Co.
Fitchburg Gas & Electric Light Co.
Lynchburg Gas Co.
New Jersey Natural Gas Co.
New York State Electric & Gas Corp.
North Carolina Natural Gas Corp.
Northeast Georgia Municipal Gas Utilities
Northeast Utilities
Northern Utilities, Inc.
Pennsylvania Gas & Water Co.
Pequot Gas Co.
Philadelphia Electric Co.
Philadelphia Gas Works
Providence Gas Co.
Public Service Company of North Carolina, Inc.
Public Service Electric & Gas Co.
South County Gas Co.
South Jersey Gas Co.
The Southern Connecticut Gas Co.
UGI Corporation
Valley Gas Co.
Washington Gas Light Co.

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF AMICUS CURIAE	1
CONSENT OF THE PARTIES	3
SUMMARY OF ARGUMENT	3
ARGUMENT	4
I. THE QUESTION OF WHETHER THIS COURT'S DECISION IN THE *NORTHERN NATURAL* CASE WAS OVERRULED BY THE NATURAL GAS POLICY ACT OF 1978 IS SUBSTANTIAL	4
II. REGULATION OF INTERSTATE GAS PIPELINES, AS MANDATED BY THE NATURAL GAS ACT, CONTINUES TO BE THE RESPONSIBILITY OF THE FEDERAL GOVERNMENT	8
III. PROCEEDINGS CURRENTLY PENDING IN THE FEDERAL ENERGY REGULATORY COMMISSION ARE ON A COLLISION COURSE WITH THE MISSISSIPPI RATABLE-TAKE RULING	11
IV. THE GROWTH OF DIVERGENT STATE REGULATION OF INTERSTATE PIPELINE PURCHASING PRACTICES STANDS AS A SIGNIFICANT THREAT TO THE INTERESTS OF THE NATION'S GAS CONSUMERS	14
CONCLUSION	16

TABLE OF AUTHORITIES

Cases: Page

Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, —— U.S. ——, 103 S. Ct. 1905 (1983) 8, 16

Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378 (1959) 14

Burbank v. Lockheed Air Terminal, 411 U.S. 624 (1973) 15

Exxon Corp. v. Eagerton, —— U.S. ——, 103 S. Ct. 2296 (1983) 5

Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944) 6, 16

Federal Power Commission v. Texaco, Inc., 417 U.S. 380 (1974) 16

Federal Power Commission v. Transcontinental Gas Pipe Line Corporation, 365 U.S. 1 (1961) .. 15

Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132 (1963) 13

Maryland v. Louisiana, 451 U.S. 725 (1981) 7, 13

Missouri ex. rel. Barrett v. Kansas Natural Gas Co., 265 U.S. 298 (1924) 5

Mobil Oil Corp. v. Federal Power Commission, 417 U.S. 283 (1974) 16

Northern Natural Gas Co. v. State Corporation Commission, 372 U.S. 84 (1963) ..... *passim*

Pacific Gas and Electric Co. v. State Energy Resources Conservation and Development Commission, —— U.S. ——, 103 S.Ct. 1713 (1983) .. 13

Decisions and Orders of the Federal Energy Regulatory Commission:

Columbia Gas Transmission Corporation, Docket No. TA81-1-21, *et al.*, Opinion No. 204, 26 FERC ¶ 61,034 (January 16, 1984), *appeal docketed*, No. 84-1099, *et al.* (D.C. Cir.) 9, 10, 13

El Paso Natural Gas Company, Docket No. RP82-33, *et al.*, Order on Rehearing Modifying Prior Orders, Consolidating Cases, and Setting Hearing, 26 FERC ¶ 61,366 (March 21, 1984) 10

TABLE OF AUTHORITIES—Continued

Page

MIGC, Inc., Docket No. RP84-15-000, *et al.*, Order Accepting Filing, Consolidating Proceedings and Setting Matters for Hearing, 26 FERC ¶ 61,369 (March 21, 1984) 10

Panhandle Eastern Pipe Line Company, Docket No. TA84-1-23-002, Order Establishing Hearing Procedures, 26 FERC ¶ 61,339 (March 16, 1984) 10

Southern Natural Gas Company, Docket No. TA84-1-7-000, *et al.*, Order Consolidating Proceedings and Setting Matters for Hearing, 26 FERC ¶ 61,371 (March 21, 1984) 10

Transcontinental Gas Pipe Line Corp., Docket No. TA83-2-29-001, *et al.*, Order Establishing Hearing Procedures on Deferred Purchasing Practices Issues, 26 FERC ¶ 61,361 (March 21, 1984) 10

Transcontinental Gas Pipe Line Corp., Docket Nos. TA85-1-27-000 and TA85-1-29-001, Order Accepting and Suspending Proposed Tariff Sheets Subject to Refund and Conditions (October 31, 1984) 12

Trunkline Gas Company, Docket No. TA83-1-30-002, *et al.*, Order Setting Matter for Hearing and Consolidating Proceedings, 26 FERC ¶ 61,363 (March 21, 1984) 10

United States Constitution:

Article I, Section 8, clause 3 ("Commerce Clause") 5, 8

Article VI, Section 2 ("Supremacy Clause") 13

United States Statutes:

Natural Gas Act of 1938, 15 U.S.C. § 717 (1982) ..*passim*

Section 1(b), 15 U.S.C. § 717 9

Section 4, 15 U.S.C. § 717(c) 9, 11, 13

Section 5, 15 U.S.C. § 717(d) 9, 11, 13

Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.* (1982) ..... *passim*

Section 601(c), 15 U.S.C. § 3431(c) 11

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

BRIEF AMICUS CURIAE OF ASSOCIATED GAS DISTRIBUTORS IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

INTEREST OF AMICUS CURIAE

Associated Gas Distributors (AGD) is an unincorporated association whose members (listed on the inside cover of this brief) are gas distribution companies located along the eastern seaboard of the United States from New England through Georgia. Together, the AGD companies serve over eleven million customers, and their annual sales comprise approximately 25 percent of the gas sold through the nation's interstate gas supply network.

Each AGD member purchases its natural gas for resale from one or more of the major, regulated interstate gas pipeline companies, including the Transcontinental Gas Pipe Line Corporation (Transco), Appellant in this proceeding. A number of AGD members purchase a substantial portion of their gas supply from Transco; these AGD companies are directly affected by any increase in Transco's rates.

The purpose of the present brief amicus curiae is twofold. First, AGD seeks to emphasize the substantiality of the constitutional questions raised in this appeal by describing the historical and *continuous* federal preemption of the regulation of interstate gas pipeline companies. In particular, we note that at this very point in time, there exists an imminent possibility of collision between the Mississippi "ratable take" order, as affirmed by the Mississippi Supreme Court in its enforcement against Appellant, Transco, and a proceeding pending in the Federal Energy Regulatory Commission (FERC or Commission) to investigate that pipeline's purchasing practices.

The second purpose of AGD in submitting the present brief is to apprise the Court of the critical nature of this issue for consumers of natural gas nationwide who depend upon a comprehensive federal system of regulation of our nation's interstate gas pipeline network. As other states, including the larger, gas-producing states, begin to enforce "ratable-take" schemes against pipelines as does the Mississippi order challenged here, the consequences for the ultimate consumers, who absorb the increased costs and uncertainties that result therefrom, will be severe.

As public utilities, the members of AGD have an obligation to protect their customers against the payment of excessive and unlawful natural gas prices. Therefore, AGD has a substantial and direct interest in the outcome of this appeal. For this reason, AGD submits this brief amicus curiae in support of the Appellant.

CONSENT OF THE PARTIES

AGD has obtained the written consent of all the parties to this appeal for its filing of the present brief amicus curiae. The consent statements are attached to the original signed copy hereof filed with the Court.

SUMMARY OF ARGUMENT

I. In upholding the Mississippi Oil & Gas Board's order directing Transco to take gas ratably, the Mississippi Supreme Court held, in effect, that this Court's decision in *Northern Natural* is no longer good law as to purchases by interstate pipelines of gas whose price at the wellhead was deregulated by the Natural Gas Policy Act of 1978 (NGPA). Given that this Court rejected state regulation in this area even before the enactment of federal legislation governing interstate sales of natural gas, and that this Court relied specifically on the precedential value of *Northern Natural* in a case decided after the passage of the NGPA, the question of whether the court below misinterpreted the rationale of *Northern Natural*, in other words, whether state regulation of purchasing practices of interstate gas pipelines remains preempted by federal law, is substantial.

II. Under the Natural Gas Act of 1938 (NGA), the Federal Energy Regulatory Commission (FERC or Commission) (formerly the Federal Power Commission) was given the responsibility to regulate the purchasing practices of interstate pipeline companies. The Commission's exclusive jurisdiction over interstate pipelines was unaffected by passage of the NGPA. Proceedings to investigate the purchasing practices of pipelines which currently pend at the FERC demonstrate that the Commission is continuing to regulate in this area and, therefore, the intrusion of state regulatory agencies would be unlawful.

III. An illustration of the conflict, and potential for inconsistency, that would result from state regulation of

interstate pipeline purchasing practices is the pendency of a proceeding at the FERC to investigate the purchasing practices of Transco. It is conceivable that the Commission, pursuant to its NGA authority, will find Transco's compliance with the Mississippi ratable take order to be an unlawful purchasing practice under federal law. There exists the imminent possibility of collision between federal and state law; therefore, under this Court's interpretation of the doctrine of federal preemption, the state law must fall.

IV. In enacting the NGA and the NGPA, Congress charged the FERC with the fundamental responsibility of protecting the interests of the nation's gas consumers. Diverse, perhaps conflicting state regulation of the interstate pipeline network will ignore nationwide energy concerns, and will inhibit the ability of the FERC to fulfill its federal regulatory role.

ARGUMENT

I. THE QUESTION OF WHETHER THIS COURT'S DECISION IN THE *NORTHERN NATURAL* CASE WAS OVERRULED BY THE NATURAL GAS POLICY ACT OF 1978 IS SUBSTANTIAL.

In *Transcontinental Gas Pipe Line Corporation v. The State Oil & Gas Board of Mississippi and Coastal Exploration, Inc., et al.*, Brief for Appellant at Appendix A, the Mississippi Supreme Court was faced with the same issue that was decided by this Court in *Northern Natural Gas Co. v. State Corporation Commission*, 372 U.S. 84 (1963). Yet, in upholding the validity of the Mississippi Oil & Gas Board's "ratable take" order, the Mississippi court made the opposite decision. Whether the Mississippi Supreme Court's holding flouted a Supreme Court decision that continues to be good law after passage of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.* (1982) is a substantial question which requires a determination by this Court.

Prior to any federal regulation of sales for resale, or "wholesale sales," of natural gas in interstate commerce, this Court refused to permit state regulation in the field on the ground that it imposed a direct burden on interstate commerce in violation of the Commerce Clause of the Constitution. *See, i.e., Missouri ex rel. Barrett v. Kansas Natural Gas Co.*, 265 U.S. 298 (1924). In enacting the Natural Gas Act, 15 U.S.C. § 717 (1982), the Congressional committee reports noted that such sales

> . . . have been considered to be not local in character and, even in the absence of Congressional action, not subject to State regulation. *The basic purpose of the present legislation is to occupy this field in which the Supreme Court has held that the States may not act.*" H.R. Rep. No. 709, 75th Cong., 1st Sess. 1-2; S. Rep. No. 1162, 75th Cong., 1st Sess. 1-2 (citations omitted) (emphasis added).

Quoted in *Exxon Corp. v. Eagerton*, —— U.S. ——, 103 S. Ct. 2296, 2302-03 (1983). Thus, prior to any federal regulation—or deregulation—of the field, state regulation was considered inappropriate with regard to interstate sales of natural gas. The Natural Gas Act then was enacted to explicitly authorize federal regulation of the rates which a producer and a pipeline could charge their interstate customers on a standard of justness and reasonableness.

In 1963, this Court was presented with the question whether the State of Kansas was entitled to force an interstate pipeline company which purchased gas within the State to take ratably from all Kansas producers connected to its system. After first rejecting the State's argument that its ratable take order was directed to the "production and gathering" of natural gas, which is exempt from federal regulation under the NGA, the Court held the Kansas ratable take order invalid on the ground that it "invade[d] the exclusive jurisdiction which the Natural Gas Act has conferred upon the Federal Power Commission over the sale and transportation of natural gas in interstate commerce for resale." *Northern Natu-*

ral, 372 U.S. at 89. The Court stated that the federal regulatory scheme left no room for either direct or indirect state regulation of the prices of interstate wholesale sales of gas, *id.* at 91, and, more importantly for the purpose of these proceedings, that

> [t]he danger of interference with the federal regulatory scheme arises because these orders are unmistakably and unambiguously directed at *purchasers* who take gas in Kansas for resale after transportation in interstate commerce. In effect, these orders shift to the shoulders of interstate purchasers the burden of performing the complex task of balancing the output of thousands of natural gas wells within the State, cf. *Miller Bros. Co. v. Maryland*, 347 U.S. 340—a task which would otherwise presumably be the State Commission's. Moreover, any readjustment of purchasing patterns which such orders might require of purchasers who previously took unratably could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States. This relationship is a matter with respect to which Congress has given the Federal Power Commission paramount and exclusive authority. See *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 610.

Id. at 92. The language of this passage clearly indicates that the Court's basis for finding a federal regulatory scheme which preempted the state order was the federal regulation not simply of wellhead prices but of interstate pipeline-purchasers and their purchasing patterns, the readjustment of which could "seriously impair" the Commission's ability to regulate the pipelines' cost structures and sales to wholesale customers, i.e., distributors.

In 1978, Congress passed the Natural Gas Policy Act, 15 U.S.C. § 3301 *et seq.* (1982) (NGPA). The NGPA removed from FERC jurisdiction the regulation of well-

head prices of certain categories of gas, and restructured wellhead price regulation for the remaining categories. The NGPA did not affect the ongoing regulation of pipelines under the Natural Gas Act's just and reasonable standard.

In the present case, the Mississippi Supreme Court upheld the order of its State Oil & Gas Board directing Transco to take gas ratably from all producers in a common source of supply. The court acknowledged that if this case had been brought prior to 1978, it would have been bound by this Court's decision in *Northern Natural*, but that the key distinction between the two cases was the passage of the NGPA and the fact that the state ratable take order affected "deregulated gas." That its order was directed against an interstate pipeline which was *not* deregulated by the NGPA was not discussed.

Neither did the court acknowledge that in *Maryland v. Louisiana*, 451 U.S. 725 (1981), decided after the passage of the NGPA, this Court indicated that *Northern Natural* was still considered good law. In Maryland, the Court determined that a Louisiana "First Use" Tax on natural gas brought into the state, primarily, from the Outer Continental Shelf, which was borne by pipelines and then passed through to the ultimate consumer, "like the state Commission's order in *Northern Natural*," was "inconsistent with the federal scheme and must give way." *Id.* at 751. The Court relied heavily on *Northern Natural* for this determination, quoting the passage that described the state requirement as liable to " 'seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchaser's cost structures and eventual costs to wholesale customers who sell to consumers in other states.' " *Id.* at 750, quoting *Northern Natural*, 372 U.S. at 92.

Ironically, the Mississippi Supreme Court itself recognized that the fact that Congress had withdrawn federal regulation of wellhead pricing control did not end the

inquiry, for it quoted this Court's statement in *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission* that

> a federal decision to forego regulation in a given area may imply an authoritative federal determination that the area is best left *un*regulated, and in that event would have as much preemptive force as a decision *to* regulate.

—— U.S. ——, 103 S. Ct. 1905, 1912 (1983) (emphasis in original). Despite this statement, the court below gave no explanation, nor did it cite to a single specific authority or indicate that the legislative history was even consulted, for its conclusion that "what, and all, the Congress has done insofar as we are concerned is strip away federal regulatory authority thus leaving in effect and wholly exercisable such state regulatory authority as otherwise exists." Brief for Appellant, Appendix A at 29a. Neither did the court, in rejecting the argument that the ratable-take order violated the Commerce Clause, address the fact that this type of state regulation had been invalidated by the Supreme Court prior to any federal regulation in the area.

State authority to regulate interstate pipeline purchasing practices through measures such as ratable take orders has *never* existed, was specifically rejected by the Court in *Northern Natural* on grounds independent from those aspects of federal jurisdiction which were removed by the NGPA, and cannot exist today given the FERC's pervasive regulatory authority over the purchasing practices of interstate pipelines.

II. REGULATION OF INTERSTATE GAS PIPELINES, AS MANDATED BY THE NATURAL GAS ACT, CONTINUES TO BE THE RESPONSIBILITY OF THE FEDERAL GOVERNMENT.

The Federal Energy Regulatory Commission derives its authority to oversee and regulate the purchasing practices of the nation's interstate gas pipelines from several

sources in the Natural Gas Act of 1938 (NGA), 15 U.S.C. § 717 (1982). Furthermore, the Commission's responsibilities in this area were unaffected by passage of the NGPA in 1978.

The broadest basis of FERC jurisdiction over interstate pipelines is found in Section 1(b) of the NGA. 15 U.S.C. § 717. There, the Commission is given general authority over (a) the transportation of natural gas in interstate commerce, (b) the sale in interstate commerce of natural gas for resale, and (c) companies engaged in such transportation or sale.

Several substantive provisions of the NGA specifically authorize the federal regulation of pipeline purchasing practices. Section 4 of the NGA, 15 U.S.C. § 717(c), governs pipeline rate increase proceedings, during which "interested" parties (gas producers supplying the pipeline, pipeline customers and consumer representatives) may raise questions concerning the "justness and reasonableness" of the purchasing pattern under which that pipeline either acquired its gas supply in a past period or proposes to acquire gas in the future. The Commission may then respond to these complaints by making appropriate adjustments in the pipeline's approved cost of service.[1]

Under NGA Section 5, 15 U.S.C. § 717(d), the Commission has authority to adjudicate the justness and reasonableness of any pipeline "practice" which reflects the rates and charges of that pipeline. If any such practice is found to be unjust, unreasonable or unduly discriminatory, the Commission is required by Section 5 to "fix" the practice "to be thereafter observed." Presumably, this section could provide the basis for Commission action affecting a pipeline's gas purchasing practice in a manner inconsistent with state ratable take schemes.

---

[1] *See, e.g.*, Columbia Gas Transmission Corp., Docket Nos. TA81-1-21, *et al.*, Opinion No. 204, 26 FERC ¶ 61,034 at 61,096 (January 16, 1984), *appeal docketed*, No. 84-1099 *et al.* (D.C. Cir.).

The continued vitality of the Commission's regulatory authority over the purchasing practices of interstate pipelines is evident in a series of cases currently pending at FERC which involve inquiries into the past purchasing practices of interstate pipelines. *See Panhandle Eastern Pipe Line Company*, Docket No. TA84-1-28-002, Order Establishing Hearing Procedures, 26 FERC ¶ 61,339 (March 16, 1984); *El Paso Natural Gas Company*, Docket No. RP82-33 *et al.*, Order on Rehearing Modifying Prior Orders, Consolidating Cases, and Setting Hearing, 26 FERC ¶ 61,366 (March 21, 1984); *MIGC, Inc.*, Docket No. RP84-15-000, Order Accepting Filing, Consolidating Proceedings and Setting Matters for Hearing, 26 FERC ¶ 61,369 (March 21, 1984); *Trunkline Gas Company*, Docket No. TA83-1-30-002 *et al.*, Order Setting Matter for Hearing and Consolidating Proceedings, 26 FERC ¶ 61,363 (March 21, 1984); *Southern Natural Gas Company*, Docket No. TA84-1-7-000 *et al.*, Order Consolidating Proceedings and Setting Matters for Hearing, 26 FERC ¶ 61,371 (March 21, 1984); *Transcontinental Gas Pipe Line Corp.*, Docket No. TA83-2-29-001 *et al.*, Order Establishing Hearing Procedures on Deferred Purchasing Practices Issues, 26 FERC ¶ 61,361 (March 21, 1984). Under the Commission's new hearing procedures for rate proceedings established in Opinion Nos. 204 and 204-A, *Columbia Gas Transmission Corporation*, Docket Nos. TA81-1-21, *et al.*, 26 FERC ¶ 61,034 (January 16, 1984), *appeal docketed*, No. 84-1099 *et al.* (D.C. Cir.), not only will the lawfulness of a pipeline's charged rates be judged by the NGPA considerations of fraud and abuse,[2] but parties will also be

[2] Prior to the NGPA's passage, the pipelines' ability to pass through costs of gas to the distributors was a function of the Commission's determination as to the justness and reasonableness of the proposed rates. Because the NGPA replaced the Commission's authority to determine wellhead prices as to certain gas with statutory "maximum lawful prices," the Commission was directed to deny passthrough of the wellhead cost of gas only where it

permitted to raise issues of "prudence," the traditional NGA Sections 4 and 5 measure of lawfulness, with regard to a pipeline's proposed rate increase. This opens up the possibility for a pipeline's purchase in conformity with a state ratable take scheme, and its resulting increased price of gas, to be deemed imprudent under federal standards and, therefore, unlawful.[3]

III. PROCEEDINGS CURRENTLY PENDING IN THE FEDERAL ENERGY REGULATORY COMMISSION ARE ON A COLLISION COURSE WITH THE MISSISSIPPI RATABLE-TAKE RULING.

The Federal Energy Regulatory Commission is currently conducting an investigation of the purchasing patterns and practices of Transco, the disposition of which could be directly contrary to, or inconsistent with Transco's obligation under the Mississippi ratable-take mandate.

On September 28, 1984, Transco tendered for filing its tariff sheets with the Commission seeking, among other things, a revision of the Purchased Gas Adjustment Clause contained in its FERC Gas Tariff. *Transcontinental Gas Pipe Line Corporation*, Docket Nos. TA85-1-27-000 and TA85-1-29-001. On October 12, 1984, AGD filed a Motion to Intervene and Protest in this proceeding, asserting that Transco had not demonstrated the justness and reasonableness of its proposed rate increase. AGD also raised several other important issues with regard to the purchasing practices of Transco. Specifically, AGD's motion stated that:

> AGD is aware that certain of Transco's gas supply agreements contain high percentage take-or-pay pro-

---

"determines that the amount paid [by the pipeline] was excessive due to fraud, abuse or similar grounds." 15 U.S.C. § 3431(c)(2).

[3] The responsibility of the FERC to determine the legality of pipeline purchasing practices after passage of the NGPA was explained by FERC Chairman Raymond J. O'Connor in his letter of December 13, 1984 to Senator John Heinz.

> visions substantially identical to those contracts found "unjust and unreasonable" by the Commission's Opinion No. 204. AGD is particularly interested in the manner in which higher-priced contracts with high percentage take-or-pay provisions have affected, and will continue to affect, Transco's purchasing practices and cost of gas supply. Similarly, AGD is aware that Transco's November 1984-April 1985 purchase pattern will be influenced by a ruling of the Mississippi Oil & Gas Board in which Transco is required to accept deliveries on a "ratable take" basis from certain Mississippi supply sources. It is not clear that this pattern of Mississippi purchases satisfied the just and reasonable standard applicable to Transco's purchase pattern under Sections 4 and 5 of the Natural Gas Act nor is it clear that pro rata purchases of uncontrolled wellhead purchases are consistent with the lowest reasonable cost standard.

Motion of AGD to Intervene and Protest at 7.

In its *Order Accepting and Suspending Proposed Tariff Sheets Subject to Refund and Conditions*, issued in the Transco rate proceeding on October 31, 1984, the Commission responded to AGD's concerns by ordering a public hearing "concerning the lawfulness of Transco's proposed rates, *including purchasing practices issues.*" (Emphasis added.) Although the Commission did not specify, it is reasonable to infer that the "purchasing practices issues" to be explored in the public hearing will include, *inter alia*, the justness and reasonableness of Transco's purchasing practices as they have been directed by the Mississippi Oil & Gas Board's ratable take order. The Commission stated that it was entitled to make this inquiry pursuant to its authority under the Natural Gas Act, "particularly sections 4, 5, 8 and 15 thereof. . . ." *Id.*

If, after the public hearing and investigation, the Commission finds that Transco's compliance with the Missis-

sippi ratable-take order is unjust and unreasonable,[4] the pipeline will be in the position of necessarily violating either state or federal law. The FERC would have authority, furthermore, under the Natural Gas Act Sections 4 and 5 to order Transco to adhere in the future to a particular purchasing pattern which is inconsistent with the state ratable take scheme. As this Court reiterated in the post-NGPA *Maryland v. Louisiana* case, "[t]he FERC need not adjust its ruling to accommodate" the state statute. 451 U.S. at 725. The case law clearly directs that in such a situation of actual federal-state conflict, where "compliance with both federal and state regulations is a physical impossibility," the Supremacy Clause requires the state law to fall to the federal law. *Pacific Gas and Electric Company v. State Energy Resources Conservation and Development Commission*, —— U.S. ——, 103 S. Ct. 1713, 1722 (1983), citing *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963).

Importantly, the doctrine of federal preemption does not apply only in cases of actual conflict between state and federal law. The attempted state regulation must fall in a situation where, "[a]t the very least, there is an imminent possibility of collision." *Maryland v. Louisiana*, 451 U.S. at 725, citing *Northern Natural*, 372 U.S. at 92. Therefore, given the "imminent possibility" of a FERC order directing Transco to change its purchasing pattern in a manner inconsistent with the Mississippi ratable-take scheme, this state regulation is preempted.

---

[4] It is conceivable that the FERC will rule that Transco's purchases of Mississippi gas were "imprudent," i.e. that such purchases were inconsistent with Transco's duty to acquire gas at the lowest reasonable cost and that its purchase pattern should be adjusted to exclude some portion of the Mississippi production required to be taken under that state's Oil & Gas Board's order. *See Columbia Gas Transmission Corp., supra*, 26 FERC at 61,112.

IV. THE GROWTH OF DIVERGENT STATE REGULATION OF INTERSTATE PIPELINE PURCHASING PRACTICES STANDS AS A SIGNIFICANT THREAT TO THE INTERESTS OF THE NATION'S GAS CONSUMERS.

The fundamental responsibility of the Federal Energy Regulatory Commission is to protect the nation's gas consuming public against excessive rates and charges and to set policies which provide natural gas "at the lowest reasonable rate consistent with the maintenance of adequate service." *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 388 (1959). This protection is exactly what would be lost if the states were permitted to enter individually into the field of interstate pipeline regulation.

The Mississippi Supreme Court recognized the problem for consumers and described it thus:

> Transco has the right to pass the costs it incurs in purchasing natural gas through to the consumer. 15 U.S.C. § 3431(c). In this sense, it is not Transco who experiences a burden, it is the consumer. If higher purchasing prices at the wellhead lead to higher prices to the consumer and a loss of markets, this is simply one inevitable consequence of the free market policies of the era of deregulation with respect to which Transco is vested by the negative Commerce Clause with no right to complain.

Transcontinental Gas Pipe Line Corporation, Brief for Appellant, Appendix A at 38a. What the court did not mention, however, is that out-of-state consumers who are burdened by the additional costs of pipelines' compliance with state ratable take orders have no recourse against the producing state's regulations. The Mississippi Oil & Gas Board has neither the interest nor the responsibility to assess the impact of its ratable take order on the ultimate consumers in New York and New England of the gas purchased originally from its state's producers.

In fact, as Appellant noted, the Board expressly refused to consider evidence submitted on the interstate impact of its action. Brief for Appellant at 17. This is why comprehensive federal regulation is important. The question, put by this Court, is "whether state authority can practicably regulate a given area," *Northern Natural*, 372 U.S. at 84, citing *Federal Power Commission v. Transcontinental Gas Pipe Line Corporation*, 365 U.S. 1, 19-20 (1961). In this situation, the states can not and will not consider national needs in regulation.

This problem takes on enormous proportions in light of the fact that other gas-producing states, including such heavy nationwide gas supply sources as Oklahoma and Texas, are following the lead of Mississippi and proposing to enforce ratable take obligations against interstate pipeline companies.[5] In addition to the universal insensitivity to national energy needs that would inevitably result, such state-by-state regulation over pipeline purchasing patterns would put impossible burdens on the FERC's ability to carry out its regulatory responsibilities. In a closely analogous case, this Court struck down a local airport anti-noise ordinance on federal preemption grounds, noting, *inter alia*, that if other localities followed with ordinances of their own, "it is obvious that fractionalized control of the timing of take-offs and landings would severely limit the flexibility of the FAA in controlling air flow." *Burbank v. Lockheed Air Terminal*, 411 U.S. 624, 639 (1973). Likewise, with conflicting state demands on a pipeline's purchasing pattern, the Commission would be unable to undertake any meaningful supervision of the pipelines, as it is statutorily bound to do.

This Court stated recently that

> the production and transmission of energy is an activity particularly likely to affect more than one

---

[5] See Brief for Appellant at Appendices H, at 130a-135a, and I, at 136a-152a.

> State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by States can patently interfere with broader national interests.

Arkansas Electric Cooperative Corp. v. Arkansas Public Commission, —— U.S. ——, 103 S. Ct. 1905, 1908-09 (1983). In deciding for the state regulatory scheme over the federal regulatory program, the Mississippi Supreme Court went so far as to assert that "the economic consequences of today's decision for one or more of the parties is of no significance, except insofar as the law has provided otherwise." Brief for Appellant, Appendix A at 17a. The law *has* provided otherwise by recognizing that as natural monopolies, interstate pipeline companies must be regulated, and that the Federal Energy Regulatory Commission, charged with this responsibility, is always bound to consider the economic consequences of its actions. *See, e.g., FPC v. Texaco, Inc.*, 417 U.S. 380, 399 (1974); *Mobil Oil Corp. v. FPC*, 417 U.S. 283, 318 (1974); *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

CONCLUSION

For the foregoing reasons, AGD urges the Court to note probable jurisdiction in this case.

Respectfully submitted,

FREDERICK MORING
Counsel of Record
M. LISANNE CROWLEY
CROWELL & MORING
1100 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 452-5800
Attorneys for Amicus Curiae
Associated Gas Distributors

February 1, 1985

Office-Supreme Court, U.S.
FILED
MAY 30 1985
ALEXANDER L. STEVAS,
CLERK

BEST AVAILABLE COPY

No. 84-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and
COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

JOINT APPENDIX

JOHN MARSHALL GROWER
(*Counsel of Record*)
JEFFERSON D. STEWART
R. WILSON MONTJOY II
BRUNINI, GRANTHAM, GROWER & HEWES
1400 First National Bank Bldg.
Post Office Drawer 119
Jackson, Mississippi 39205
Telephone: (601) 948-3101

R. V. LOFTIN, JR.
THOMAS E. SKAINS
DAVID A. GLENN
Transcontinental Gas Pipe Line Corporation

Attorneys for Appellant

EDWIN LLOYD PITTMAN
Attorney General
State of Mississippi

ED DAVIS NOBLE, JR.
(*Counsel of Record*)

LLOYD ARNOLD
Office of the Attorney General
P.O. Box 220
Jackson, Mississippi 39205
The State Oil and Gas Board of Mississippi

GLENN GATES TAYLOR
COPELAND, COOK, TAYLOR & BUSH
P.O. Drawer 2132
Jackson, Mississippi 39225
Coastal Exploration, Inc.

Attorneys for Appellees

JURISDICTIONAL STATEMENT FILED JANUARY 2, 1985
JURISDICTION NOTED MARCH 25, 1985

TABLE OF CONTENTS

	Page
SIGNIFICANT EVENTS IN THE PROCEEDINGS (In lieu of Docket Entries)	JA-1
EXCERPTS FROM TESTIMONY OF WILBUR H. KNIGHT	JA-2
Direct Examination	JA-2
Exhibit 1	JA-5
Exhibit 3	JA-10
Cross Examination	JA-16
Redirect Examination	JA-20
EXCERPTS FROM THE TESTIMONY OF JULIUS RIDGWAY	JA-24
Direct Examination	JA-24
Exhibit 4	JA-29
Exhibit 7	JA-34
Exhibit 8	JA-39
Exhibit 9	JA-48
Exhibit 10	JA-54
Exhibit 11	JA-58
Exhibit 12	JA-66
Exhibit 13	JA-71
Cross Examination	JA-78
Exhibit 1	JA-81
EXCERPTS FROM THE TESTIMONY OF GERALD BRAUTIGAM	JA-84
Direct Examination	JA-84
EXCERPTS FROM THE TESTIMONY OF JAMES L. HALL	JA-90
Direct Examination	JA-90
Cross Examination	JA-92

TABLE OF CONTENTS continued

Page

EXCERPTS FROM THE TESTIMONY OF RAY CORCORAN ... JA-98

Direct Examination JA-98

Exhibit 1 .....JA-101

Cross Examination JA-108

EXCERPTS FROM THE TESTIMONY OF TRISHA POLLARD ..JA-118

Direct Examination JA-118

Cross Examination JA-135

Redirect Examination JA-137

EXCERPTS FROM THE TESTIMONY OF CLAUDE MULLENDORE JA-141

Direct Examination JA-141

Exhibit 1 .....JA-174

Exhibit 2 .....JA-208

Cross Examination JA-214

Redirect Examination JA-235

EXCERPTS FROM THE MISSISSIPPI STATE OIL AND GAS BOARD ORDER ESTABLISHING GAS ALLOWABLES FOR APRIL 1, 1982 TO OCTOBER 1, 1982 .....JA-240

Significant events in the proceedings

(IN LIEU OF DOCKET ENTRIES)

Date—Event—Record Page

7/29/82—Petition of Coastal Exploration Inc. filed in the State Oil and Gas Board of Miss.—19-26.

9/14-16/82—Hearing on the Petition of Coastal Exploration Inc. by State Oil and Gas Board of Miss.—88-527.

10/13/82—Entry of Order No. 409-82 by the State Oil and Gas Board of Miss.—533-42 App. C to Juris. State.

10/15/82—Petition to appeal filed by Transcontinental Gas Pipe Line Corp. in the Circuit Court of the First Judicial District of Mississippi.—546-7.

6/29/83—Entry of Memorandum Opinion and Order of the Circuit Court of the First Judicial District of Hinds County, MS—698-739 App. B to Juris. State.

7/7/83—Petition for appeal to the Mississippi Supreme Court filed by Transcontinental Gas Pipe Line Corporation—741-2.

9/5/84—Entry of Order and Opinion of the Mississippi Supreme Court affirming in part, reversing and rendering in part, and remanding to the Circuit Court with directions.—App. A and E to Juris. State.

9/24/84—Motion for Rehearing filed by Coastal Exploration, Inc.—

10/3/84—Entry of Order denying Motion for rehearing.—App. D. to Juris. State.

11/30/84—Notice of Appeal to the United States Supreme Court filed by Transcontinental Gas Pipe Line Corporation.—App. F to Juris. State.

1/2/85—Jurisdictional Statement docketed in the United States Supreme Court.—

3/25/85—Probable jurisdiction noted.—

Excerpts from testimony of Wilbur H. Knight

[96]

WILBUR H. KNIGHT

Having been duly sworn by the Chairman, gave the following testimony:

DIRECT EXAMINATION

BY MR. TAYLOR

Q. Will you state your name, please, sir? A. I am Wilbur H. Knight.

Q. Mr. Knight, where do you live? A. I live in Jackson, Mississippi.

Q. What is your occupation? A. I'm a consulting petroleum geologist.

Q. Have you previously appeared to testify before this Board as a consulting petroleum geologist? A. I have.

Q. Were your qualifications accepted at that time? A. They were.

BY MR. TAYLOR.

Mr. Chairman, we tender the witness as an expert in petroleum geology.

BY CHAIRMAN FANCHER:

Let the record show the qualifications of Mr. Knight are accepted by the Board.

Q. (Mr. Taylor) Mr. Knight, I believe you are familiar with the petition which has been filed in this docket [97] by Coastal Exploration, Inc. A. I am.

Q. And it seeks to require Transcontinental Gas Pipe Line Company to take ratably from Coastal Exploration,

Inc. insofar as its interest is concerned in wells producing from the Harper Sand Gas Pool in Greens Creek and Morgantown Fields. A. That's correct.

Q. And you have read the petition and are familiar with it? A. I am.

Q. Have you undertaken a study of the Harper Sand Gas Pool as it underlays portions of Greens Creek and Morgantown Field in Jefferson Davis and Marion Counties, Mississippi? A. I have.

Q. And have you prepared and brought with you exhibits which will assist you in your testimony? A. I have.

Q. Would you identify your first exhibit, please, sir? A. Exhibit 1 is a structure map on top of the Harper Gas Sand.

Q. Was it prepared by you or under your supervision? A. It was prepared by me.

Q. Is it correct and accurate? A. It is.

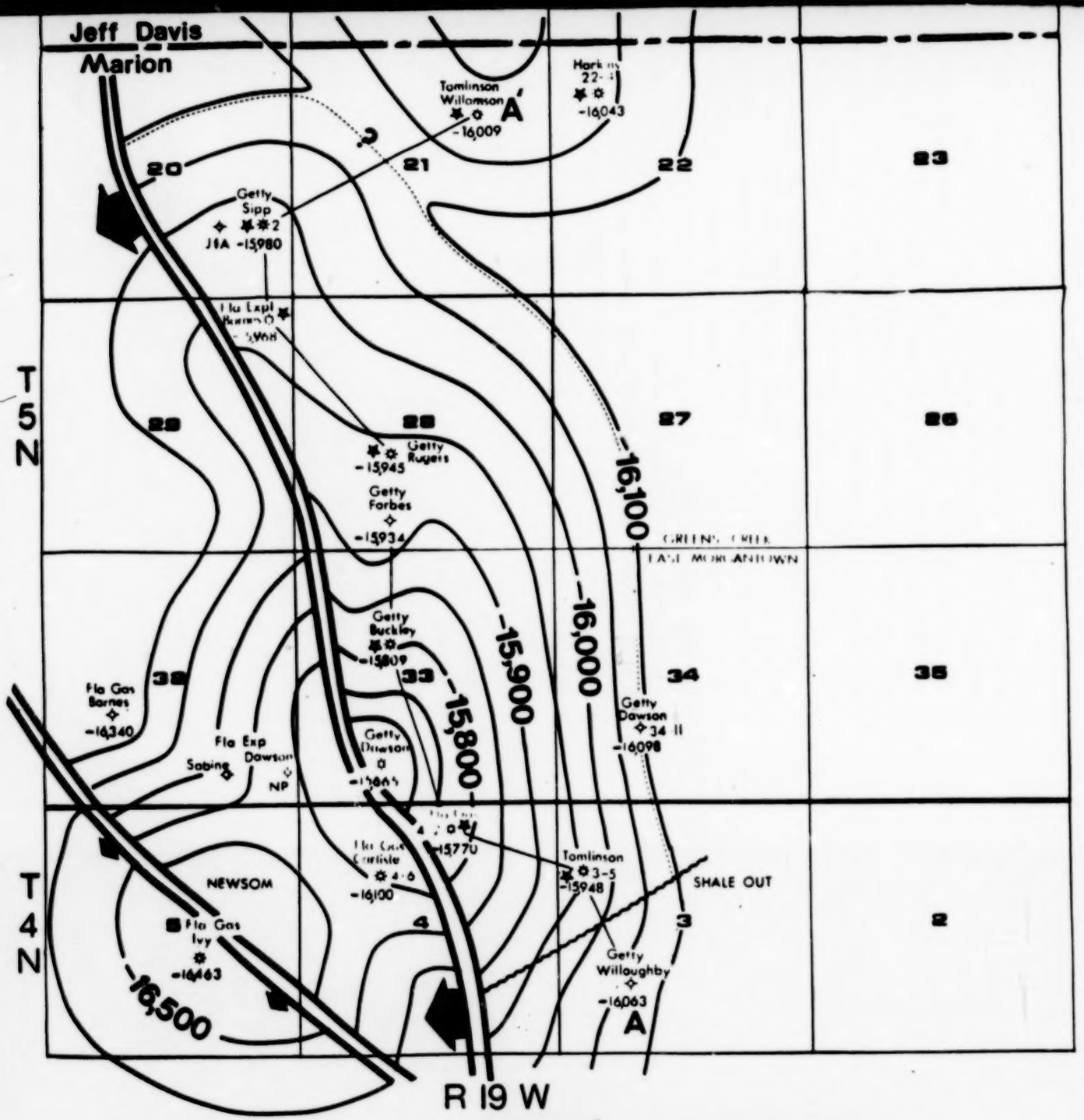
[98] BY MR. TAYLOR:

Mr. Chairman, we would offer as Exhibit 1 the structure map on the Harper Sand prepared by Mr. Knight.

BY CHAIRMAN FANCHER:

All right, let it be marked.

(THE STRUCTURE MAP WAS MARKED AS EXHIBIT 1 TO THE TESTIMONY OF MR. KNIGHT AND APPEARS AS FOLLOWS:)



Parts of

NEWSOM, E. MORGANTOWN & GREENS CREEK FIELD

JEFF DAVIS & MARION COS., MISS.

Structure - Top Harper Gas Sd.

SCALE 2,000 4,000 6,000 FT

Docket No. 287-82-418 & 467
Exhibit No. 1
Wilbur H. Knight

for Julius Ridgway

Aug. 1982

[100] Mr. Knight, would you explain your Exhibit 1, please sir? A. Yes. This is a map drawn on a scale of one inch equals 2,000 feet of the southern part of the Greens Creek Field and the northern part of the East Morgantown Field. The structure contours are drawn on the top of the reservoir, 50 foot intervals. The wells producing from the Harper Gas Sand Pool are identified by the stars. The wells in which Coastal has a particular interest are those wells that are identified by a pink circle. This map shows that the reservoir is basically closure against a fault, which is downthrown to the west, and there is some question indicated by my question mark whether or not the Harper Gas Pool is continuous across a low relief structural saddle and continues on up into Greens Creek proper, which would be off the map to the north.

Q. That's the—the part that is behind your question mark between the Thomlinson-Williamson Well and the Getty-Sipp Well? A. That is correct. The yellow line outlines the boundaries of the Harper Gas Pool if you restrict it across the line in Section 21. My next exhibit will demonstrate that a little more clearly—the uncertainty of that separation in that area.

Q. Mr. Knight, I believe you have identified six wells producing from this common pool, is that correct? [101] A. Well, there is more than six I have identified. If you include the wells in 21 and 22—if you exclude them, then there are six wells in the pool, yes.

Q. That would be the Getty-Sipp, the Florida-Barnes, the Getty-Rogers, the Getty-Buckley, the Florida-Carlisle Number 2, and the Tomlinson-Willoughby. A. 3-5, that's correct.

Q. Do you have a second exhibit that you brought with you today? A. Yes.

Q. Would you identify this exhibit, please? A. Yes. This is a cross section along the orange line drawn on the map, which is identified as A-A Prime, with A-Prime being to the north and A being to the south.

Q. Was this cross section prepared by you? A. It was.

Q. Is it accurate? A. Yes.

BY MR. TAYLOR:

Mr. Chairman, we offer into evidence as Exhibit 2 the cross section prepared by Mr. Knight.

BY CHAIRMAN FANCHER:

All right, let it be marked and received in evidence.

• • • • • • • • • • •

[103] Q. Would you explain Exhibit 2, please, sir? A. Yes, Exhibit 2 shows the pertinent part of the electric logs of the eight wells on the cross section. The cross section is a structured cross section showing the comparative subsea depth of the pool in all of the wells, and also, by means of the yellow coloring I have indicated the very readily correlatable Harper Sand from well to well across the entire section until you get to the right-hand well, which is the Getty-Willoughby 3-11, where the Harper Sand is shaled out and there is a upper Harper Sand that I have identified as a stray sand, which is nonproductive and not a part of the reservoir.

Again, I call your attention to the area between the two left-most wells where I have the little question mark, and there is some question whether or not the Harper Sand dips below the gas/water contact at approximately minus 16,100 feet and separates it from Greens Creek proper. There is evidence indicating that it could extend and be part of the Greens Creek proper Harper Gas Pool. But in any event, there is absolutely no question whatsoever that

the three wells, which I have underscored in pink, are in the same reservoir as the wells between them. Those six wells are producing from a common pool in the intervals shown by the heavy blocks, which are the perforated intervals in each well.

Q. Mr. Knight, have you prepared and brought with [104] you an exhibit which would reflect the productive history of the six wells which you have testified are producing from a common pool? A Yes, I have.

Q. Would you identify what you have handed me, please, sir? A. This exhibit is entitled Gas Production from Selected Wells Producing from the Harper Gas Pool, Greens Creek and East Morgantown Field, Jefferson Davis and Marion County, Mississippi.

Q. Did you prepare this exhibit? A. I did.

Q. Was it prepared from the official records of the State Oil and Gas Board? A. It was.

BY MR. TAYLOR:

The Chairman, we would offer into evidence as Exhibit 3 the past production history prepared by Mr. Knight.

BY CHAIRMAN FANCHER:

All right, sir, it will be received.

(THE PRODUCTION HISTORY WAS MARKED AS EXHIBIT 3 TO THE TESTIMONY OF MR. KNIGHT AND APPEARS AS FOLLOWS:)

Exhibit 3

GAS PRODUCTION FROM SELECTED WELLS PRODUCING FROM THE HARPER GAS POOL, GREENS CREEK AND EAST MORGANTOWN FIELDS, JEFFERSON DAVIS AND MARION COUNTIES, MISSISSIPPI

YEAR/MO.	GETTY— #2 SIPP 20-9	FLA. EXPL.— #1 BARNES	GETTY— ROGERS 28-11	GETTY— BUCKLEY 33-6	FLA. EXPL.— CARLISLE 4-2	TOMLINSON WILLOUGHBY
April	0	0	86,262	88,227	0	0
May	0	0	184,120	199,572	0	0
June	0	0	193,521	182,550	0	0
July	0	0	209,978	154,546	0	0
August	0	0	215,712	105,314	0	0
September	0	0	214,808	98,012	0	0
October	11,985	0	219,782	87,147	0	0
November	115,171	0	228,329	69,356	0	0
December	108,340	0	242,225	70,445	0	0

1982

January	81,389	0	236,094	69,625	0	0
February	76,900	0	220,415	59,241	0	0
March	75,962	0	245,884	62,441	0	0
April	70,050	0	226,372	76,546	70,323	41,748
May	74,240	0	228,458	194,425	144,120	116,534
June	63,557	0	221,384	193,647	132,677	125,528
		1st Prod. 7-2-82				
TOTALS	677-594 MCF	0	3,173,344 MCF	1,711,094 MCF	347,120 MCF	283,810 MCF

(Information obtained from Mississippi State Oil and Gas Board Form No. 9)

WILBUR H. KNIGHT
August, 1982

[106] Q. (Mr. Taylor) Mr. Knight, I believe your Exhibit 3 shows that the date of the first production from the Getty-Rogers Wells occurred in April of 1981? A. That's correct.

Q. And the next of the three wells that you have underscored on your Exhibit 2, the Getty-Sipp Well, began producing in October of 1981? A. That's correct.

Q. And then the Tomlinson-Willoughby Well began producing in April 1982? A. That's correct.

Q. Mr. Knight, would you describe the Harper Sand Gas Pool as you have depicted on your Exhibits 1 and 2 as a gas condensate reservoir? A. Well, it's a gas reservoir that produces condensate due to the reduction in temperature and pressure. So, it's a gas condensate reservoir in that sense, yes.

Q. Have you studied any other gas reservoirs producing condensate within the state of Mississippi? A. I have studied all of them, I believe, to some degree.

Q. Well, can you give the Board some idea as to how many you have studied? A. Different reservoirs? Oh, I would say probably 100, or more.

[107] Q. Including reservoirs within what we call the Hosston trend in south Mississippi? A. That's correct.

Q. Have you become familiar, generally, with the drainage patterns in gas condensate reservoirs of the type depicted on your Exhibits 1 and 2? A. I have.

Q. Do you have an opinion whether the six wells that you have depicted on your Exhibit 2, your cross section, whether they are competing with one another in the common pool? A. They are.

Q. In your opinion what well, or wells, in the common pool are most directly in competition with, for example, the Getty-Sipp Well? A. Well, the Florida Gas-Barnes

would be the—to answer your question in a general way, usually the geographic nearest well is the one that offers the most competition in drainage.

Q. It's a relationship of well bores? A. That's right.

Q. And what about the well that is in most direct competition with the Getty-Rogers Well? A. It would be the Florida Gas-Barnes and the Getty-Buckley.

Q. And what well would be in most direct competition [108] with the Tomlinson-Willoughby Well in the south part of the pool? A. The Florida Gas-Carlisle 4-2 Well.

Q. If the wells in the common pool are not producing ratably, would drainage occur between the developed units? A. It would.

Q. In your business have you ever been called upon to make estimates of reservoir reserves—reserves of recoverable gas and condensate? A. Many times, I have.

Q. Can you give the Board some idea of how many times you have done this? A. Well, I perhaps have made in the past 20 years several hundred separate reserve studies of different reservoirs.

Q. Would this include an area of what I have referred to as the Hosston trend? A. A substantial number of those reserve studies would be in the Hosston trend.

Q. Generally, what has been your experience in the accuracy of reserve estimates? A. Well, they become more and more accurate as you get more and more production history and more and more development.

Q. And as you get more and more production history, the reservoir is depleted? [109] A. That's correct.

Q. Taking into consideration your background in making reserve estimates and your study of the Harper Gas Sand Pool depicted on your Exhibit 1 and 2, assuming that Coastal Exploration's share of the gas in the Harper Gas

Sand Pool was to be banked or left in the ground and not produced at this time, can you give the Board some idea of the geological and reservoir risks that would occur to Coastal's opportunity to recover its share of gas from the pool? A. Well, as production proceeds in any reservoir, more especially this reservoir, the more reserves that have been produced, the less likelihood that there is a certainty that any reserves left in the ground would be there at the tail end of production when they theoretically would be recovered. So, as each day goes by the risk increases that gas left in the ground might not be there at some future time when it would be produced and this could happen for several different reasons. One, you could have some sort of calamitous occurrence to the well, casing collapse, or a premature water encroachment due to a break down in the cement job, and the delay or perhaps the unwillingness of the operator to repair the damage or attempt to repair the damage. Also, you can, at times your reservoir estimates are not ever 100 percent accurate. What you thought would be the life of the well might turn out to be somewhat shorter than estimates [110] indicated, and if that was the case, of course, the reserves wouldn't be there at the late hour in the productive life of the reservoir. So, there's many reasons why estimates of reserves we make today might prove inaccurate as the production from the reservoir continues. So that it's perfectly obvious that the longer you wait to produce gas that you leave in the ground, the more uncertain you are in your ability to recover that gas.

Q. It's because the reserves are depleting and the pressure is declining? A. That's true.

Q. I believe your Exhibit 3 reflects that all six of these wells producing from the common pool are now, in fact, producing gas. A. Oh, yes. I might add to that, the one figure that was not available when I typed this exhibit, but I did check the July production of all of these wells and the five wells were essentially the same as shown in the preced-

ing month; however, the Florida Gas-Barnes Well produced 159 million cubic feet during the month of July 1982. So, it's an excellent well.

Q. You testified a few minutes ago about the unratable withdrawals from the wells. In your opinion will waste occur if there are unratable withdrawals of these six wells completed in the common pool? [111] A. Well, as long as a well is capable and they are produced disproportionately, there will be waste occurring, actually net drainage to the higher wells. That's perfectly obvious. Now, if a well is incapable of producing the maximum out, that's another story. If it's not capable, it just can't do it under any circumstances. But if there is artificial controls on the rate and they are not equal, as long as a well is capable of competing with the others, why then, definitely there is waste being committed in the sense that the drainage is disproportionate.

Q. In your opinion if there were unratable withdrawals of gas from the six wells completed in this common pool, would the coequal and correlative rights of the owners in the pool be protected? A. Yes, in a fundamental and basic way. They would not be protected if the rates were not uniform. If they were not uniform and the wells were capable of uniform production, their coequal and correlative rights would not be protected.

Q. That would be all the more the case where if someone's gas in the parlance of the industry was left in the ground? A. That's true.

BY MR. TAYLOR:

Mr. Chairman, that's all the questions we have of this witness.

BY CHAIRMAN FANCHER:

All right, Mr. Stewart or Mr. Grower, cross examination?

[112] CROSS EXAMINATION

BY MR. STEWART:

Q. Mr. Knight, you have indicated that you have got a separate pool by your geologic exhibit. Has this pool been defined in the records of the State Oil and Gas Board? A. Yes, it's been defined and I have those definitions here. It's been defined twice. It's been defined both in the Greens Creek Field and in the East Morgantown Field. If you would like, I think I can refer to notes and tell you which are the type wells in each field. Is that necessary? Would you like me to do that?

Q. No, that's not necessary. A. But it has been defined, yes.

Q. Is there another Harper Sand Gas Pool in East Morgantown and Greens Creek Field other than the one you have shown here? A. In a technical or a geological sense, yes, because of the separation that I believe is present will separate the north Harper from the south Harper, but the Board does not recognize that and as far as they are concerned the Harper Pool is a single pool in the East Morgantown Field.

Q. They do not recognize this particular pool that you are showing as a separate pool from other Harper Sand Pools in the East Morgantown or the Greens Creek? A. Well, they recognize—the Getty-Rogers Well, if you will notice on my map I have indicated the Greens Creek [113] and East Morgantown. The Getty-Buckley Well is in the East Morgantown Field. The Getty-Rogers Well just north of it is in the Greens Creek Field. Now, these two fields started out many miles apart and then as development proceeded they grew closer and closer together and finally they met up. It's perfectly obvious that the southern part of Greens Creek and the northern part of East Morgantown are the same Harper Pool, although the Board recognizes a separation between 28 and 33.

Q. According to the Special Field Rules by the Board in these two units though, the Buckley and the Willoughby Well and the Carlisle Well are in the Harper Sand Gas Pool of East Morgantown and the Rogers and the Barnes and Sipp Wells and the Williamson Well are in the Harper Sand Gas Pool in Greens Creek Field, is that correct? A. That is exactly true.

Q. You have also testified, I believe, that it is possible that the J. C. Williamson Well up in Section 21 may be associated with this pool and may be in the common accumulation? A. That is correct. Not only the Williamson, but wells further north off of my map in the main part of Greens Creek Field.

Q. So, those wells could also be competing for the same common source? A. In a general way, yes, because they would all be producing from the same pool.

[114] Q. You were asked some hypothetical questions about producing ratably from this well. Are you telling the Board that these wells, based on the production figures you have given, that they have been producing ratably up until now? A. No, I didn't say that.

Q. Have you made a study to determine whether or not they have been producing ratably? A. I think my exhibit that I offered to the Board shows that none of the wells have produced exactly or even approximately the same amount of gas during their productive life.

Q. And this, of course, is a function of the ability of the wells to produce as much as they can when they can do it, is that correct? A. Presuming that the purchase will take all they can produce.

Q. Have you made a determination as to whether or not any of these wells have been producing within their allowables, or exactly what allowable has been assigned to each of these wells? A. No, I have not.

Q. If a well produces in excess of its allowable, in your opinion would that well be producing unratably with other wells? A. That's right. However, under our formula it would [115] have a period of time to adjust its over-production. So, over a longer period of time, if the allowable rule was enforced properly then they should balance out.

Q. Now, the Rogers 28-11 Well that you have shown here, has already produced in excess of three billion cubic feet out of this reservoir, is that correct? A. That's correct.

Q. Do you know what the producing rate for the Rogers Well is? A. In July of this year it was 208 million cubic feet per month.

Q. What does that translate to per day? A. Say, about seven million feet a day.

Q. There is no question then that the Rogers Well has drained acreage under the Barnes Well and under the Getty-Sipp Well, is there? A. No, because the Rogers Well is—these wells all drain from the same pool. It's just a matter of degree. So, the Rogers Well has drained from the—predominantly from its offsetting tracts—the part of 29 and the part of 33 that's underlain with the reservoir. That's the area where most of the drainage took place from the Rogers Well.

Q. And as long as the Rogers Well continues to produce more per day or per month than either the Barnes or the Sipp Well, then it will continue to drain from that acreage, will it not? [116] A. Yes.

Q. And the Buckley Well produced over 1.7 billion cubic feet from this reservoir. It likewise has drained gas from under the Carlisle Well and the Tomlinson-Willoughby Well, has it not? A. That's true because its been in production just about a year longer than the other two wells.

Q. And it's current rates are in excess of both the

Carlisle and the Willoughby Well, are they not? A. That's correct.

Q. And as long as that continues they will continue to drain from those uints, will they not? A. Well, it's really, we are kind of over-simplifying this because the Getty-Buckley is right in the middle of the reservoir and it's basically draining off of its own unit predominantly. If there is any drainage—actually, if you go to drainage on an acre/foot basis or the underlain acres, then there wouldn't be any drainage because those two wells have relatively a small portion of the reservoir underlying their units. But if you take it just on the basis of the well and forget the geology and forget the unit assignment, then the more gas any given well produces over the life of the reservoir, it's going to be draining the other wells.

Q. These wells are not producing at uniform rates in this pool, are they? [117] A. It's perfectly obvious that this exhibit speaks for itself.

Q. They are producing disproportionately to the number of acres that are assigned to each unit for that well, are they not? A. Very definitely.

Q. All of these production figures that you have shown in here for the months of 1981 and 1982 were prior to the time that Coastal filed its petition and prior to the time that Transcontinental indicated any desire not to take anyone's gas from this well, is that correct? A. I can check the record. I don't know when this petition was filed precisely, but my records go through June. Then if the petition was filed after that—that record will have to speak for itself. I can't answer specifically.

BY MR. STEWART:

Thank you.

REDIRECT EXAMINATION

BY MR. TAYLOR:

Q. Mr. Knight, notwithstanding the fact that the Special Field Rules for Greens Creek and Morgantown Field define on paper a separation, it's your testimony that you are of the opinion that the six wells indicated on your Exhibit 1 are, in fact, producing from a common pool? A. That's correct. There is absolutely no doubt about [118] it. I think the geological evidence is overwhelming and this is demonstrated very clearly both by my maps and this cross section. The correlations are excellent. The reservoir gas/oil ratio from all the wells is essentially the same. Any parameter you want to use for analysis indicates beyond any doubt that these wells are all producing from the same reservoir.

Q. Mr. Stewart asked you some questions about ratable production. Ratable production does not necessarily mean equal production between wells, does it?

BY MR. STEWART:

I object to that question. I think that is a matter of law for the Board to determine. Mr. Knight has certainly already testified as to his opinion as to what ratable production is.

BY CHAIRMAN FANCHER:

Well, I had a hard time understand what that had anything to do with in the first place, Mr. Stewart, so, I will let him ask his question.

(PENDING QUESTION READ BACK BY THE COURT REPORTER)

A. (The witness) I presume ratable production means production that follows a rate that has been established, and my understanding of that word means that if a well is capable of producing a certain amount of gas as com-

pared to another well, then they should produce the same amount and that would [119] be ratable production and in that case it would be equal production.

Q. But on your Exhibit 3 you are showing figures for production, say, the June 1982 production for the wells—everything except the Barnes—none of the wells are producing equal amounts of gas, are they? A. No.

Q. That is not to say that they are not—that any given well is not producing at its maximum efficient rate. A. No, not at all.

BY MR. STEWART:

I'm going to object to the form of the question. Mr. Taylor, he didn't swear in, and if he wants to testify——

BY CHAIRMAN FANCHER:

Yes, I think you're leading him a little bit, Mr. Taylor

BY MR. TAYLOR:

Yes, sir, I'll stop leading him.

Q. (Mr. Taylor) Mr. Knight, Mr. Stewart alluded Transco's desire not to take certain gas from this pool. If Transco, if as between two wells that were producing at their maximum efficient rate of flow, one of the wells was cut back because Transco desired not to take certain gas from that well, in your opinion would there be unratable withdrawals as between those two wells in the common pool? A. The answer to that question, I think, would depend [120] ultimately on how the allowables, if any, were applied to the production from the wells. If the wells were entitled to produce their maximum efficient rate for a long period of time, and that was—then one well that was capable of producing more was arbitrarily cut back, that would penalize the owners of the well that was capable of the best production. Now then, whether or not that would be an appropriate thing to do, I just can't answer that. If the

absence—if we apply the allowables, then it will correct itself, but if there is no application of allowables to the matter, then I think that cutting back a well that is capable of a higher rate of production would penalize the people in that well.

Q. By penalize, you mean it would result in unratable withdrawals in the common pool? A. If we are using rate to mean the maximum efficient rate, it very definitely would.

BY MR. TAYLOR:

That's all the questions I have of this witness.

BY CHAIRMAN FANCHER:

Any re-cross, Mr. Stewart?

BY MR. STEWART:

No, sir.

EXAMINATION BY CHAIRMAN FANCHER:

Q. Mr. Knight, you said something that kind of bothered me. You said something about the allowables being [121] properly enforced. Did you intend to imply by that that the allowables were not being properly enforced? A. No, no. What I meant to say is if the allowables are fixed in such a way that all except the low volume deficient wells would produce over years period of time very close to the same amounts of gas, then this matter would not take on the situation that we see here, and the allowables have been fixed in this case, presumably, at a high rate where all wells except the highest well, presumably, is not capable of making its allowable. So, no, I meant no implication at all that the Board was not enforcing the allowables.

Q. Well, are you thinking that we should change our allowable rule as to the production of gas? A. Mr. Chairman, that's a difficult question, and I would decline to answer it just on the spur of the moment.

BY CHAIRMAN FANCHER:

Okay. Thank you.

FURTHER REDIRECT EXAMINATION
BY MR. TAYLOR:

Q. Mr. Knight, the chairman spoke about allowables. I believe that allowables in this state are based on deliverability capacity of wells, are they not?

BY MR. STEWART:

Mr. Chairman, that's not an accurate portrayal of the Statewide Rule 34.

BY CHAIRMAN FANCHER:

Well, it's pretty close, I think, Mr. Stewart.

[122] BY MR. TAYLOR:

Q. Well, as between, say, let's take our six wells that you have shown on your Exhibit 3, take, for example, the Getty-Sipp Well, had an allowable based upon its deliverability capacity, but as Mr. Stewart said, Transco desired not to take a certain percentage of gas produced from that well and cut the well back to below its deliverability capacity, do you have an opinion as to whether or not that would result in waste to the owners in the Sipp well? A. No question about it, it would. It would result in waste to them.

BY MR. TAYLOR:

That's all the questions I have of this witness.

BY MR. STEWART:

No further questions.

BY CHAIRMAN FANCHER:

Call your next witness.

Excerpts from the testimony of Julius Ridgway

JULIUS RIDGWAY

Having been duly sworn by the Chairman, gave the following testimony:

DIRECT EXAMINATION

BY MR. TAYLOR:

Q. State your name, please, sir. A. Julius Ridgway.

Q. Mr. Ridgway, where do you live? [123] A. I live in Jackson, Mississippi at 51 East Brooke.

Q. What is your occupation? A. I'm engaged in petroleum exploration and oil and gas business.

Q. Are you appearing here today on behalf of Coastal Exploration, Inc., the Petitioner? A. Yes, I am.

Q. Do you hold any position in Coastal Exploration? A. I'm the president of the corporation and I own 100 percent of it.

Q. How many employees do you have? A. I have three employees.

Q. Who owns the stock in Coastal Exploration, Inc? A. I own the stock.

Q. Are you Coastal? A. Yes, I'm Coastal.

Q. Are you a major or an independent? A. I'm an independent operator.

Q. Mr. Ridgway, would you give the Board the benefit of your educational background? A. Yes, I graduated from the University of Mississippi with a Bachelor of Science in Geological Engineering in 1956.

Q. What about your work experience in the area of oil and gas? A. I was employed in 1958 as a petroleum geolo-

gist [124] for a family company, Ridgway Management, and in 1966 I was employed by the First National Bank in the Petroleum Department until 1973.

Q. What did you do with the First National Bank? A. I supervised the oil and gas loans.

Q. Did that call on you to make, for example, reserve estimates? A. Yes, it did.

Q. Geological studies? A. That's right.

Q. What about in your work in the family business, did that likewise call on you to make geological evaluations? A. That's correct.

Q. Has your business since 1958 included buying and trading in oil and gas leases? A. That's correct.

Q. And developing leases by drilling wells? A. That's correct.

Q. Can you give the Board some idea of how many wells you have drilled in the state of Mississippi since 1958, or participated in the drilling of? A. I would expect it is in excess of 200 wells.

Q. Are you familiar with what I call the Hosston trend? A. Yes, I am.

[125] Q. In what area of the state is it found? A. The Hosston trend primarily lies within what is called the Mississippi Salt Basin, and that is in the counties, Covington, Jeff Davis, Lawrence, Marion and Lamar Counties, primarily.

Q. How would you describe your involvement in the development of the Hosston trend in Mississippi? A. I became active in 1975 acquiring leases and participating in the development and drilling of prospects and development of fields in this area since that time.

Q. How many wells do you and your company own an interest in in the Hosston trend? A. We own interests in 18 producing wells in the Hosston trend.

Q. Can you give the Board some idea of the fields you own an interest in in this area? A. Yes, they are included in Oakvale, West Oakvale, Greens Creek, East Morgantown, Columbia and Improve.

Q. Would you characterize you and your company's ownership in these areas as ownerships of small or large undivided working interests? A. These are small working interests. They are comprised of lease interests that range from one acre in size to less than 20 acres in size.

Q. How have you sold the gas produced from these wells? [126] A. I, as a practice, have relied on the operator in each unit to market and sell my gas to their purchasers.

Q. Is that usual or unusual? A. That's the usual practice in the industry.

Q. Do you know who has been buying your gas from the 18 wells that you own an interest in in the Hosston trend? A. Yes, Transco is the purchaser of all the gas from all these wells—not all of the gas, but from all of these wells.

Q. By Transco, do you mean Transcontinental Pipe Line Company? A. That's correct.

Q. As a non-operator/producer, have you previously ever had to sign a gas contract in order to sell your share of production from these wells? A. I have only been required or asked to sign a gas purchase contract in the case in which I was acting as the operator.

Q. That was in West Oakvale? A. Yes, that was in West Oakvale, recently.

BY CHAIRMAN FANCHER:

Mr. Taylor, let me stop you right here because I anticipate there is going to be an effort to get a lot of contracts into evidence. We may admit them into evidence, but we are not going to consider them. Contracts are not this Board's business.

[127] BY MR. TAYLOR:

I couldn't agree more and I only have one.

BY CHAIRMAN FANCHER:

So, let's don't get into contracts with him.

BY MR. TAYLOR:

Mr. Chairman, I'm simply attempting to show that the customs practiced in the industry by owners of small working interests has been not to sign contracts.

BY CHAIRMAN FANCHER:

I understand that, but let's don't talk about contracts.

BY MR. TAYLOR:

Mr. Chairman, we would tender the witness at this time as an expert in petroleum geology and as an expert in the development of oil and gas interests in the Hosston trend.

BY CHAIRMAN FANCHER:

Mr. Stewart, any objections to the qualifications of the witness?

BY MR. STEWART:

No, Mr. Chairman.

BY CHAIRMAN FANCHER:

Let the record show that the qualifications of the witness are accepted.

BY MR. TAYLOR:

Q. Mr. Ridgway, have you undertaken a study of the Harper Sand Gas Pool of the Hosston formation in the area of [128] Greens Creek and Morgantown Fields? A. Yes, I had Mr. Wilbur Knight prepare the exhibit for this testimony.

Q. Have you become familiar with the relative production and pattern of history of the wells which he identified as being in the common pool? A. Yes, I have.

Q. Have you previously reviewed Exhibit 1, which Mr. Knight prepared? A. Yes, I have studied this.

Q. Do you have an opinion as to whether or not the six wells he has identified in his Exhibit 1 are, in fact, completed into and producing from a common pool? A. It is my opinion that they are producing from a common pool.

Q. Mr. Ridgway, how many of those six wells does Coastal Exploration own an interest in? A. They own an interest in four of the six wells.

Q. I show you this document and ask you if you can identify it. A. (Examines document) Yes, this is a schedule of the working interest percentages I have in the four wells that I own within this area designated.

Q. Is this exhibit correct and accurate? A. Yes, it is.

[129] BY MR. TAYLOR:

Mr. Chairman, we would offer this summary of ownership as Exhibit 4.

BY CHAIRMAN FANCHER:

All right, let it be marked.

(THE SUMMARY OF OWNERSHIP WAS MARKED AS EXHIBIT 4 TO THE TESTIMONY OF MR. RIDGWAY AND APPEARS AS FOLLOWS:)

Exhibit 4

COASTAL EXPLORATION INC.'S OWNERSHIP IN WELLS & UNITS

WELLS & UNITS	PERCENT OF OWNERSHIP INTEREST IN UNIT
Getty Oil Co.—Rogers 28-11 Well No. 1	.0261220
Getty Oil Co.—Sipp 20-9 Well No. 2	.0066552
Tomlinson Interests, Inc.— Willoughby 3-5 Well No. 1	.00468750
Florida Exploration Co.— Barnes 29-1 Well No. 1	.0015625

[131] BY MR. TAYLOR:

Q. Mr. Ridgway, I believe that in only one of these wells does your interest, and by that I mean Coastal's interest, exceed one percent in the unit, is that correct? A. That is correct.

Q. That would be in the Getty-Rogers Well? A. That is in the Getty-Rogers Well where my largest interest is situated.

Q. Did Coastal pay its way on these four wells it owns an interest in the common pool? A. Yes, I participated in paying my pro rata part of the drilling and development costs in all of these wells.

Q. What about ongoing operating costs? A. I have also paid my share of the ongoing operating costs, yes, in each of these wells.

Q. Mr. Ridgway, after the four wells identified on Exhibit 4 were drilled and completed, what arrangements did Coastal make to market its share of gas to be produced from these wells? A. The arrangement that I made for the marketing of our share of gas was done by the usual industry practice that I'm familiar with, whereby, the operator, being Getty in the case of the Rogers and the Sipp, and Tomlinson in the case of the Willoughby, and Florida Exploration with the Barnes; whereby, they sent to the minority working interest owners, [132] those who had been nonsignatory parties to the gas contract, they sent this letter agreement asking for authorization to sell our share of the gas under the Operating Agreement subject to the terms of the contract which they had entered into.

Q. Why did you not sign your own gas contracts for your interest in these four wells? A. I was never offered the opportunity by either the purchaser or the operator.

Q. Well, is it usual or unusual in the business for the owner of a small undivided interest like yourself not to

sign a gas contract? A. It's the usual custom and practice not to sign a not to sign a contract or a ratification.

Q. Mr. Ridgway, I hand you this document and ask you if you can identify it. A. (Examines document) Yes, this is the—I don't know whether we want to get into this, but this a gas purchase contract.

Q. Can you identify which gas purchase contract? A. Between Getty Oil Company, as the seller, and Transcontinental Gas Pipe Line Corporation, as the buyer.

Q. Is that the contract under which your gas has been sold from the Getty-Sipp, the Getty-Rogers and the Tomlinson-Willoughby Wells? A. That is correct.

[133] BY MR. TAYLOR:

Mr. Chairman, we would offer into evidence as Exhibit 5 a copy of the contract, for the record.

BY CHAIRMAN FANCHER:

We will admit it for the record, and for the fact that the contract is in existence.

• • • • • • • • • •

[134] BY MR. TAYLOR:

Mr. Chairman, we would also offer for the record at this time a copy of the Ratification and Amendment of Gas Purchase Contract executed by Tomlinson and other working interest owners covering the Willoughby Well. This has been produced by Transco pursuant to a subpoena duces tecum.

BY CHAIRMAN FANCHER:

Who is going to identify it.

BY MR. TERRELL:

Let me look at it. (Examines document) We can identify it, Mr. Chairman.

BY MR. STEWART:

We would stipulate that this is a copy.

BY CHAIRMAN FANCHER:

Okay, by stipulation then it will be admitted for the record.

BY MR. TAYLOR:

Mr. Chairman, do you want a copy of it?

BY CHAIRMAN FANCHER:

No, sir.

[135] BY MR. TAYLOR:

Mr. Chairman, we would also offer into evidence at this time another document produced by Transcontinental in response to a subpoena duces tecum, which is a letter of April 15, 1982, reflecting the prices being paid under the contract introduced as Exhibit 5.

BY CHAIRMAN FANCHER:

Has Mr. Stewart seen that, or did he furnish it?

BY MR. TAYLOR:

He furnished it to me.

BY MR. STEWART:

We will stipulate this document is authenic but we disagree with the fact that it does reflect the current price being paid. It reflects the terms and conditions of a redetermination of the price.

BY CHAIRMAN FANCHER:

All right, sir. Again, we will admit it for the record, not for its contents.

BY MR. TAYLOR:

Mr. Chairman, my purpose in introducing this is to show that the price which has subsequently been offered to my client is a price which is different from that which has been paid to the operator of the wells. My ultimate purpose being to show that the price is discriminatory.

BY CHAIRMAN FANCHER:

Well, Mr. Taylor, we don't have anything to do with [136] fixing the price of gas. We do classify wells under the NGBA, but then when you get out into the purchase and sale, we don't have anything to do with that.

BY MR. TAYLOR:

Mr. Chairman, my only point is, for the record, that under Rule 48 I need to establish that Transco is proposing to purchase with discrimination. In order to show that I need to at least, for the record, show that they are offering different prices to owners in the same pool. That is our purpose in offering this exhibit.

BY CHAIRMAN FANCHER:

All right. Let it be introduced for the record.

(THE LETTER DATED APRIL 15, 1982, WAS MARKED AS EXHIBIT 7, FOR THE RECORD, AND APPEARS AS FOLLOWS:)

Exhibit 7

CONFORMED COPY
CONTRACT #007 06991

Transcontinental Gas
Pipe Line Corporation

A Subsidiary of Transco Companies Inc.

2700 Post Oak Boulevard
P.O. Box 1396
Houston, Texas 77001
713-871-8000

April 15, 1982

Getty Oil Company
P.O. Box 1404
Houston, TX 77001

Attention: Natural Gas Department

R: Transco's Gas Purchase Agreement #06991—Newsom Field, Marion County, Mississippi

Gentlemen:

Reference is made to the subject gas purchase agreement (Agreement) dated August 6, 1980 between Transcontinental Gas Pipe Line Corporation, as Buyer, and Getty Oil Company, as Seller, in the Newsom Field, Marion County, Mississippi.

Pursuant to Section 2.B.(3) of Article X, "Price", of the Agreement, Seller has requested in writing a redetermination of the price, effective April 1, 1982.

Seller has chosen the price provided by Subsection B. (4)(b) of Section 2 of Article X which is "the arithmetic average of the three (3) highest prices per MMBtu contracted for and being paid by an interstate pipeline, as of the date of such request, for gas of a similar quality and

comparable quantity and delivery conditions under contracts of ten (10) years term or more covering gas produced and delivered within the State of Mississippi and adjacent offshore areas under state or federal taxing authority."

The highest prices of which Transco is aware and can verify for gas contracted for and being paid on March 29, 1982 are prices which appear in its own Gas Purchase Agreements as follows:

St. Joe Petroleum (U.S.) Corporation	#06696
Greens Creek Field, Mississippi	$8.665/MMBtu
Harkins & Company	#06687
Greens Creek Field, Mississippi	$8.665/MMBtu
CanDel Oil (U.S.), Inc.	#06697
Greens Creek Field, Mississippi	$8.665/MMBtu

The arithmetic average of the above prices is $8.665 per MMBtu. However, Section 2.D. of Article X, "Price" of the Agreement provides in part:

> "Notwithstanding any other provisions in this agreement, the price to be paid for gas delivered or for which payment is due hereunder shall never exceed one hundred ten percent (110%) of the equivalent price per MMBTU for No. 2 Fuel Oil. . . ."

The most current price available on March 29, 1982 for No. 2 Fuel Oil as determined in Section 2.B.(4)(c) of Article X of the Agreement was the February, 1982 price of $.997 per gallon. Pursuant to the subject Agreement, each gallon of No. 2 Fuel Oil is deemed to contain 0.1387 MMBtu. Therefore, $.997 per gallon of No. 2 Fuel Oil converts to $7.188 per MMBtu.

In view of the above and subject to the terms and conditions of the Agreement, Buyer offers Seller one hundred

ten percent (110%) of the No. 2 Fuel Oil price as converted, that price being $7.907 per MMBtu, plus taxes, effective April 1, 1982.

Please indicate your concurrence by the execution of two (2) copies of this letter agreement. One (1) fully executed original should be returned to Transco for our use and file.

Very truly yours,

/s/ J. PHIL MCGOWAN, JR.
J. Phil McGowan, Jr.
Vice President – Gas Purchases

BFB
MH

CHM/BFB/pm
GASS/w07178

ACCEPTED and AGREED to this
7th day of May, 1982

GETTY OIL COMPANY

By /s/ JERRY JONES
Jerry Jones
Attoney-in-Fact

[139] BY THE CHAIRMAN:

Mr. Taylor, I think what you need to show—I hadn't heard anybody say yet—I understand that Transco refused to buy this gas.

BY MR. TAYLOR:

That's where I'm going.

BY CHAIRMAN FANCHER:

All right, let's get to it.

BY MR. TAYLOR:

Q. I believe that Exhibit 3 reflects that the Getty-Rogers Well went on production as early as April 1981, is that correct? A. That is correct.

Q. And followed by the Getty-Sipp Well, which went on production in October of 1981, is that correct? A. That is correct.

Q. And then the Tomlinson-Willoughby Well, which you also own an interest in, came on production in April 1982. A. That is also correct.

Q. Now, was "your" share of gas being produced when these two wells first began producing? A. Yes, my share of gas has been produced right along with that of the operator and purchased by Transco, the purchaser, since the first production.

Q. To the best of your knowledge was your share of [140] gas produced ratably from these wells? A. To the best of my knowledge it has been produced ratably.

Q. Do you know on what basis Transco took and purchased your gas from the date of first production until at least this summer? A. Yes, they have purchased my gas on the same terms and conditions that they purchased gas from the operator.

Q. Were you paid for your gas which was taken and purchased by Transco? A. Yes, I have been paid.

Q. Until at least this summer? A. I have been paid up through the most recent payment, but I have been notified I may not be paid in the future.

Q. That's my next question, Mr. Ridgway, at some point in time were you advised by the operator or by Transco that Transco proposed not to continue taking and purchasing your share of gas produced from the Sipp, Rogers and Willoughby Wells? A. Yes, we received a letter from Transcontinental, as well as a letter from Getty, notifying us of the intention to discontinue purchasing gas from the nonsignatory parties to the gas purchase contract, that being those parties that never signed the actual ratification or the contract.

[141] Q. Mr. Ridgway, I hand you a letter dated June 17, 1982, and ask you if you can identify that, please. A. (Examines document) Yes, this is a copy of the letter that I received from Getty.

BY MR. TAYLOR:

Mr. Chairman, we would offer this into evidence as Petitioner's Exhibit 8.

BY CHAIRMAN FANCHER:

Any objection, Mr. Stewart?

BY MR. STEWART:

No.

BY CHAIRMAN FANCHER:

All right, let it be marked and received in evidence.

(THE LETTER OF JUNE 17, 1982, FROM GETTY WAS MARKED AS EXHIBIT 8 TO THE TESTIMONY OF MR. RIDGWAY AND APPEARS AS FOLLOWS:)

Exhibit 8

GETTY

Getty Oil Company
Post Office Box 1404, Houston, Texas 77001
Telephone: (713) 658-9361

Natural Gas Sales and Purchases

June 17, 1982

WORKING INTEREST OWNERS

RE: GETTY OIL COMPANY OPERATED WELLS:
Buckley 33-6 No. 1,
Dawson 33-14 No. 1,
Rogers 28-14 No. 1,
Morgan 9-14 No. 1, and
Sipp 20-19 No. 2

Newsom Field, Marion County, Mississippi

Gentlemen:

Since initial deliveries, Getty, as operator, of the captioned wells, has been marketing several working interest owner's share of gas production in accordance with ARTICLE VI., C., of the various operating Agreements covering each well. The Operating Agreements state that Getty, as operator, has the right but not the obligation to purchase and dispose of gas for which any working interest owner fails to make marketing arrangements.

Transcontinental Gas Pipe Line Corporation (Transco), by letter dated May 19, 1982, notified Getty that effective June 1, 1982, Transco would only take gas produced attributable to the pro rata working interest of parties that have executed gas purchase contracts (Transco's letter attached). In subsequent conversations with Transco we have not been able to convince Transco to continue taking non-signatory parties gas in the Newsom Field Area. How-

ever, we have been successful in obtaining an extension to the effective date of this notice to *July 1, 1982.* Getty recommends that each non-signatory party immediately make arrangements to contract their working interest share of the gas production from the captioned wells.

Getty hereby notifies each working interest owner that their share of gas production from the captioned Getty operated wells will be deferred or under-produced effective *July 1, 1982* unless Getty is notified of contract arrangements.

If you have any questions concerning this notice, please call David Zarider, (713) 651-4465 or Ray Corcoran (713) 651-4462.

Very truly yours,

GETTY OIL COMPANY

/s/ RAY CORCORAN
Ray Corcoran
Gas Activities Manager

DZ/RC/ss
cc: Ms. Trisha S. Pollard
Transcontinental Gas Pipe Line Corporation

Transcontinental Gas
Pipe Line Corporation

A Subsidiary of Transco Companies Inc.

2700 Post Oak Boulevard
P.O. Box 1396
Houston, Texas 77001
713-871-8000

May 19, 1982

Getty Oil Company
P. O. Box 1404
Houston, Texas 77001

Attention: Mr. E. R. Corcoran

Re: Transco's Gas Purchase Agreements #06991, #61008, #06646, #61084, #61039, #61045, #61218, #61220 and #06855—Newsom Field, Marion County, Mississippi

Gentlemen:

This is to advise you that as of June 1, 1982, Transcontinental Gas Pipe Line Corporation (Transco) requests that gas deliveries for wells in the subject field operated by Getty Oil Company (Getty) and committed under the subject gas purchase agreement with Getty (#06991), and other gas purchase contracts between Transco and Florida Exploration Company (#61008); Tomlinson Interests, Inc. (#06646); Jones-O'Brien, Incorporated (#61084); Southland Royalty Company (#61039); ACF Petroleum Company, Inc., Drillamex Inc., and Ocelot Oil Company (#61045); Sabine Production Company (#61218 and #61220); Tomlinson Interests, Inc., Transco Exploration Company, Weaver Oil and Gas Corporation, Marline '78 Company (U.S.A.), Albert F. Thomasson, Burgess A. Thomasson, Richard Bertram & Co., ProCo, Inc., Jacksoco Oil Co., Inc., and Louis Mullen (#06855) be reduced to

contract minimum quantities attributable to their working interest until further notice.

Effective June 1, 1982 Transco will only take production attributable to the pro rata working interest of the above-named signatory parties under the various Getty wells, and until further notice will no longer take any gas being sold by the operator under the operating agreement.

This action is being taken because the volume of gas which is currently available for delivery to Transco under its existing gas purchase agreements substantially exceeds the demand for gas in our market areas. Also, the decline in oil and other fuel prices, coupled with increasing gas purchase costs, has resulted in the loss of some industrial market in the areas served by Transco's system. It is anticipated that this situation will result in additional market loss by certain of our distribution customers. Transco must, therefore, take measures such as this to reduce our takes in fields where we are currently taking more gas than is dedicated under contract. Similar notices containing this request are being given by Transco in all instances where permitted by contract.

Should you have any questions, please call Ms. Trisha S. Pollard at 713/871-2552.

Very truly yours,

TRANSCONTINENTAL GAS PIPE LINE CORPORATION

/s/ J. PHIL MCGOWAN, JR.
J. Phil McGowan, Jr.
Vice President – Gas Purchases

JPMc:lkk
cc: see attached list

GPC #61008

Florida Exploration Company
1990 Post Oak Blvd., Suite 77056
-Attn: Mr. R. D. Gramling

GPC #06646

Tomlinson Interests, Inc.
925 Houston Natural Gas Building
Houston, Texas 77002
-Attn: Mr. Jim S. Denison

GPC #61084

Jones O'Brien, Incorporated
P. O. Box 5928
Shreveport, Louisiana 71105-0928
-Attn: Mr. Tom F. Jordan

GPC #61045

ACF Petroleum Company, Inc.
c/ Florida Exploration Company
1990 Post Oak Blvd., Suite 1400
Houston, Texas 77056
-Attn: Mr. R. D. Gramling

Drillamex Inc.
c/o American Express Company
Investment Division—39th Floor
125 Broadway
New York, New York 10019
-Attn: Mr. Robert Rank

Ocelot Oil Company
c/o Florida Exploration Company
1990 Post Oak Blvd., Suite 1400
Houston, Texas 77056
-Attn: Mr. R. D. Gramling

GPC #61218

Sabine Production Company
1200 Mercantile Bank Building
Dallas, Texas 75201
-Attn: Mr. Louis Morrison

GPC #61039

Southland Royalty Company
1000 Fort Worth Club Tower
Fort Worth, Texas 76102
-Attn: Mr. John Legg

GPC #06855

Tomlinson Interests, Inc.
925 Houston Natural Gas Building
Houston, Texas 77002
-Attn: Mr. Jim S. Denison

Transco Exploration Company
P. O. Box 1396
Houston, Texas 77251
-Attn: Mr. N. W. Wilson, III

Marline '78 Company (U.S.A.)
4900 Capital Bank Plaza
Houston, Texas 77002
-Attn: Mr. A. B. Copland

Weaver Oil and Gas Corporation
5599 San Felipe, Suite 1100
Houston, Texas 77056
-Attn: Mr. L. D. Ferrin

Albert F. Thomasson
3940 Montclair Road, Suite 503
Birmingham, Alabama 35213

Burgess A. Thomasson
P. O. Box 1641
Mobile, Alabama 36633

Richard Bertram & Co.
P. O. Box 59-2737
Miami, Florida

Jacksoco Oil Co., Inc.
P. O. Box 173
Mobile, Alabama 36601
–Attn: Mr. Robert Jackson

ProCo, Inc.
1122 First National Bank Building
Jackson, Mississippi 39205
–Attn: Mr. Homer Lynn

Louis Mullen
P. O. Box 929
Brookhaven, Mississippi 39601

[143] BY MR. TAYLOR:

Q. Mr. Ridgway, I believe that Exhibit 8 has attached to it a copy of a letter dated May 19, 1982, from Transco, is that correct? A. The letter dated May 19, 1982, from Transcontinental Gas Pipe Line to Getty, yes.

Q. Would you read the second paragraph of the letter, please, sir? A. (Reading) "Effective June 1, 1982, Transco will only take production attributable to the pro rata working interests of the above named signatory parties under the various Getty wells, and until further notice will no longer take any gas being sold by the operator under the Operating Agreement."

Q. Would you turn back to the first page of Exhibit 8 and will you, if you would, please, read the first sentence of the second paragraph. A. (Reading) "Transcontinental Gas Pipe Line Corporation (Transco), by letter dated May 19, 1982, notified Getty that effective June 1, 1982, Transco would only take gas produced attributable to the pro rata working interests of parties that have executed gas purchase contracts. Transco's letter attached."

Q. Let me stop you at this point, Mr. Ridgway, as of this date, June 17, had you signed a gas contract with Transco? [144] A. No, I had not signed a gas purchase contract with Transco.

Q. Would you read the next sentence, please, sir? A. (Reading) "In subsequent conversations with Transco we have not been able to convince Transco to continue taking nonsignatory parties gas in the Newsom Field Area."

Q. Now, would you read the first sentence of the third paragraph? A. (Reading) "Getty hereby notifies each working interest owner that their share of gas production from the captioned Getty operated wells will be deferred or underproduced effective July 1, 1982, unless Getty is notified of contract arrangements."

Q. And by referring to the above referenced wells they

are referring specifically to the Rogers Well and the Sipp Well that you own an interest in? A. That's correct. I would also like to point out that in the May 19th letter from Transco, there was attached that I was not among those listed in the first paragraph.

Q. I'm not following that. A. Well, the sentence that we read stated that the above named signatory parties under the various Getty wells, and I was not in that group.

Q. You were not in the group of people whose gas they would continue to take? [145] A. That's correct, yes, sir.

Q. Now, I show you a letter dated May 20, 1982, on the letterhead of Tomlinson Interests and ask you if you can identify that. A. Yes, I received a copy of this letter from Tomlinson Interests dated May 20, 1982.

BY MR. TAYLOR:

Mr. Chairman, we would offer this into evidence as Exhibit 9.

BY CHAIRMAN FANCHER:

Mr. Stewart, have you seen it?

BY MR. STEWART:

Yes, sir.

BY CHAIRMAN FANCHER:

Any objection?

BY MR. STEWART:

No.

BY CHAIRMAN FANCHER:

All right, let it be marked.

(THE LETTER DATED MAY 20, 1982, FROM TOMLINSON INTERESTS WAS MARKED AS EXHIBIT 9 TO THE TESTIMONY OF MR. RIDGWAY AND APPEARS AS FOLLOWS:)

Exhibit 9

TOMLINSON INTERESTS, INC.

925 Houston Natural Gas Building
Houston, Texas 77002
713-651-9701

Jim S. Denison, Jr.
Manager
Natural Gas Department

May 20, 1982

WORKING INTERESTS OWNERS
IDENTIFIED ON ATTACHED
DISTRIBUTION LIST

Gas Sales Arrangements
Willoughby 3-5 Well No. 1
E. Morgantown Field, Marion County, Mississippi

You each own a working interest in gas from the subject well operated by Tomlinson Interests, Inc. Information available to us at this time indicates that all (or a portion) of your gas is still uncommitted.

Approximately 58% of the gas from this well is attributable to certain leases acquired from Getty Oil Company, which leases are covered by that certain gas purchase contract dated August 6, 1980 between Getty and Transcontinental Gas Pipe Line Corporation. Tomlinson and those working interest owners with production attributable to the leases acquired from Getty have ratified the Getty-Transco contract with respect to such production. The remaining, approximately 42% of the gas from the well is not so committed, and Transco was unwilling to accept the commitment of any working interest owner's share thereof absent agreement to amend said contract to include language which would allow Transco, at its option,

to reduce the price payable thereunder so as to assure their competitiveness in their marketing areas. This condition was unacceptable to the working interest owners who have ratified the Getty-Transco contract; and, Transco has verbally indicated that they intend to limit their takes to the gas which is attributable to the leases acquired from Getty.

Pursuant to the terms of that certain operating agreement dated October 1, 1981, covering all of Section 3, Township 4 North, Range 19 West, in the subject field, each party shall take in kind or separately dispose of its proportionate share of gas production. In the event any party or parties fail(s) to make disposition of its (their) pro rata part of said production gas balancing will be implemented under the gas balancing agreement attached as Exhibit "E" to the aforesaid operating agreement.

Inasmuch as deliveries of gas were begun to Transco on April 18, 1982, we will appreciate your notifying us at your earliest convenience of the arrangements you have made or intend to make for disposition of your share of uncommitted production. If you have made no such arrangements, to the extent that production is not curtailed by Transco, we plan to disburse to you, for so long as your gas remains uncommitted, your pro rata share of the proceeds we receive from Transco. Therefore, it is imperative that we receive from you advice as to the commitment status of your gas.

Attached, for your convenience in responding to us, is a form. Please complete it so as to accurately reflect the status of your gas and return same to the following address:

Tomlinson Interests, Inc.
925 Houston Natural Gas Building
Houston, Texas 77002
Attention: Mr. R. E. Sagstetter
Manager, Revenue Accounting

Thank you for your cooperation in this matter.

Sincerely,

TOMLINSON INTERESTS, INC.

/s/ JIM S. DENISON, JR.
Jim S. Denison, Jr.
Manager, Natural Gas Department

cc: Paula Broussard
Tom Graves
Judy Rogers
Terry Ryan
Ray Sagstetter

[148] BY MR. TAYLOR:

Q. You previously testified you received notices from both Getty and Tomlinson that Transco would not take your share of gas, is that correct? A. That's correct.

Q. Is what has been marked as Exhibit 9 the notification you received from Tomlinson? A. Yes, it is from Tomlinson Interests.

Q. In the second paragraph, Mr. Ridgway, would you begin reading with the sentence that begins, "The remaining approximately 42 percent . . ." A. (Reading) "The remaining approximately 42 percent of the gas from the well is not so committed and Transco was unwilling to accept the commitment of any working interest owner's share thereof absent an agreement to amend said contract to include language which would allow Transco, at its option, to reduce the price payable thereunder so as to assure competitiveness in their marketing areas."

Q. Let me stop you for just a minute. When it refers to "the well" was it referring to the Willoughby Well? A. The Number 1 Willoughby 3-5.

Q. Would you continue with the next sentence, please?

BY MR. STEWART:

Mr. Chairman, I think the letter pretty much speaks for itself.

[149] BY MR. TAYLOR:

Mr. Chairman, my only point is that this is a lot of paper to put before the Board and I'm just trying to pull out the relevant portions of the letter and move on.

BY CHAIRMAN FANCHER:

All right, sir.

BY MR. STEWART:

If he could just highlight those portions and present them to the Board, that would be fine with us.

BY CHAIRMAN FANCHER:

I think he could do that, but we will give him reasonable latitude to proceed with the information.

BY MR. TAYLOR:

Q. Now, Mr. Ridgway, would you read the next sentence? A. (Reading) "This condition was unacceptable to the working interest owners who have ratified the Getty/Transco contract and Transco has verbally indicated that they intend to limit their takes to the gas which is attributable to the leases acquired from Getty."

Q. Now, would you go to what appears to be the last paragraph on that page and read the next to the last sentence? A. (Reading) "If you have made no such arrangements to the extent the production is not curtailed by Transco, we plan to disburse to you, so long as your gas remains uncommitted, [150] your pro rata of the proceeds we receive from Transco."

Q. What did you do in response to this letter? A. I signed a letter authorizing Tomlinson to market my share of gas under the terms of their Operating Agreement and contract.

Q. After you received what has been marked as Exhibits 8 and 9, did you contact Transco about that? A. Yes, I communicated directly with Transco requesting to become a party to the gas purchase contract and to ratify the same.

Q. What did Transco tell you? A. Transco indicated to me that they would not allow me to do that.

Q. Did Transco at that point offer you a contract for your gas? A. They did not offer me a contract at that

time; however, they did say that if there was a contract available it would be subject to what is termed the market out provision and a present price of five dollars a thousand.

Q. What was your understanding of how Transco and the operators proposed not to produce your share of gas but yet continued to produce the wells? A. My understanding is the way they termed it, it would be deferred or banked or left in the ground until some undetermined later date.

[151] Q. Mr. Ridgway, since the filing of this petition, have you received additional notices from Getty and Tomlinson confirming that Transco proposes not to take your gas? A. Yes, I received a copy of this letter dated August 23, 1982 from Getty confirming this.

BY MR. TAYLOR:

Mr. Chairman, we would offer as Exhibit 10 a copy of the letter of August 23, 1982, on Getty letterhead addressed to Coastal Exploration, Inc.

BY CHAIRMAN FANCHER:

Let it be marked.

(THE LETTER OF AUGUST 23, 1985, FROM GETTY TO COASTAL WAS MARKED AS EXHIBIT 10 TO THE TESTIMONY OF MR. RIDGWAY AND APPEARS AS FOLLOWS:)

Exhibit 10

GETTY

Getty Oil Company
Post Office Box 1404, Houston, Texas 77251
Telephone (713) 651-5000

Natural Gas Sales and Purchases

HOUSTON, TEXAS
AUGUST 23, 1982

TO ALL WORKING INTEREST OWNERS
IN GETTY OIL COMPANY - OPERATED
WELLS IN NEWSOM FIELD,
MARION COUNTY, MISSISSIPPI
Buckley 33-6 No. 1
Dawson 33-14 No. 1
Rogers 28-11 No. 1
Morgan 9-14 No. 1
Sipp 20-9 No. 2

Gentlemen:

In Getty Oil Company's (Getty) letter of June 17, 1982, we informed you of Transcontinental Gas Pipeline Corporation's (Transco) refusal to purchase gas of non-signatory parties to Gas Purchase Contracts with Transco. Previously, Transco had purchased such parties' gas which Getty had tendered to Transco under the terms of various operating agreements. Coastal Exploration, Inc., a non-signatory party who received this notice, has petitioned the Mississippi Oil and Gas Board under Docket Nos. 287-82-418 and 287-82-467 to enter an order under its Rule 48 for Transco to take ratably from all producers in the field without discrimination. At Transco's request, a hearing on August 18, 1982 was postponed until September 14, 1982 at which time the cause is due to go forward and evidence is scheduled to be heard.

Transco has curtailed its purchase of gas under Getty's Gas Purchase Contract and regretably, more curtailment may occur in the future. Transco has done so despite the fact that Getty has repeatedly requested that Transco refrain from such action until the Mississippi Oil and Gas Board has ruled on the above mentioned docketed cases. In an effort to reduce the hardship to those non-operators who have not been able to arrange a market for their gas, Getty will distribute to all working interest owners on a pro rata basis the revenues attributable to production for the month of July. This course of action is being embarked upon even though it is detrimental to and creates a hardship on Getty.

Very truly yours,

GETTY OIL COMPANY

/s/ RAY CORCORAN

Ray Corcoran
Gas Activities Manager

[153] BY MR. TAYLOR:

Q. Mr. Ridgway, would you read the first sentence in the first paragraph? A. (Reading) "In Getty Oil Company's letter of June 17, 1982, we informed you of Transcontinental Gas Pipe Line Corporation's refusal to purchase gas of nonsignatory parties to gas purchase contracts with Transco."

Q. Mr. Ridgway, does that describe you, are you a nonsignatory party to a gas contract? A. Yes, I am a nonsignatory party to the gas purchase contract.

Q. Would you read the first sentence of the second paragraph? A. (Reading) "Transco has curtailed its purchase of gas under Getty's gas purchase contract and regrettably more curtailment may occur in the future."

Q. Mr. Ridgway, I believe you said you also, subsequent to the filing of this petition, received a like notice from Tomlinson. I'm handling you a letter of August 23, 1982, and ask you if you can identify that? A. Yes, I received a copy of this letter dealing with the Willoughby 3-5 Number 1 Well.

BY MR. TAYLOR:

Mr. Chairman, we would offer this into evidence as Exhibit 11.

[154] BY CHAIRMAN FANCHER:

All right, sir.

BY MR. STEWART:

Mr. Chairman, we have not been provided with a copy of this letter, if I could take a moment to look at it.

BY CHAIRMAN FANCHER:

All right. (OFF THE RECORD BRIEFLY.) Do you have any objection, Mr. Stewart?

BY MR. STEWART:

No.

BY CHAIRMAN FANCHER:

Let it be marked.

(THE LETTER DATED AUGUST 23, 1982, FROM TOMLINSON TO COASTAL WAS MARKED EXHIBIT 11 TO THE TESTIMONY OF MR. RIDGWAY AND APPEARS AS FOLLOWS:)

Exhibit 11

TOMLINSON INTERESTS, INC.

925 Houston Natural Gas Building
Houston, Texas 77002
713-651-9701

Jim S. Denson, Jr.
Manager
Natural Gas Department

August 23, 1982

WORKING INTEREST OWNERS

F. W. Willoughby 3-5 No. 1 Well
E. Morgantown Field, Marion County, Mississippi

Attached, for your information, is a copy of a letter dated August 19, 1982 from Transcontinental Gas Pipe Line Corporation wherein they notify Tomlinson Interests, Inc., operator of the subject well, that, effective August 19, 1982, they will only take production attributable to the pro rata working interests of those working interest owners who are signatories to that certain gas purchase contract dated April 15, 1982 between said owners and Transcontinental, and that until further notice they will not accept any gas being sold by Tomlinson Interests, Inc. under the operating agreement covering said well. As you will recall, only about 58% of the gas from this well is committed to Transcontinental, such gas being attributable to leases acquired from Getty Oil Company.

Interests in this gas which are attributable to leases other than those acquired from Getty are either committed to Tennessee Gas Pipeline Company or are uncommitted. In the latter instance, uncommitted gas (including Tomlinson Interests' share thereof) is being delivered to Transcontinental under the terms of that certain operating agreement dated October 1, 1981. Tennessee Gas has not con-

nected this well to its system as yet and, thus, is not in position to accept any deliveries.

Although the petition filed July 24, 1982 with the Mississippi Oil & Gas Board by Coastal Exploration, Inc. (Docket No. 287-82-418 and Docket No. 287-82-467), wherein the Board has been asked to required Transcontinental to take gas from this and other wells ratably, may impact Transcontinental's decision in this instance, Tomlinson Interests is prepared to continue to accomodate those working interest owners wishing us to market their gas under the terms of the aforesaid operating agreement—to the extent we can do so contractually. You should be aware that, notwithstanding Transcontinental's notice that they will not accept gas sold by the operator under the operating agreement, our gas purchase contract specifically obligates them to purchase at least 50% of any "excess gas" available to us during October 1 – May 1 each year under a gas balancing agreement or other similar agreement. Moreover, under the terms of our contract, Transcontinental must increase their takes for such time and in such amount as is necessary to offset drainage: The subject well is completed in the Harper Sand which is being drained by other production, as quickly as we are able to document the extent of such drainage we intend to request Transcontinental to increase their takes accordingly.

We will use our best efforts to keep you apprised of the developments regarding this situation. In the meantime, should you have any questions, please contact me.

Sincerely,

TOMLINSON INTERESTS, INC.

Original Signed:
Jim S. Denison, Jr.

Jim S. Denison, Jr.
Manager, Natural Gas Department

cc: Mr. Toxey M. Puckett
Tomlinson Interests, Inc.
111 Capitol Building, Suite 290
111 East Capital Street
Jackson, Mississippi 39201

Mr. Vernon L. Terrell, Jr., Esquire
Plauche, Hartley, Lapeyre & Ottinger
One Shell Square, Suite 3618
New Orleans, Louisiana 70139

Mr. Tom Graves
Tomlinson Interests, Inc.
925 Houston Natural Gas Building
Houston, Texas 77002

Transcontinental Gas
Pipe Line Corporation

A Subsidiary of Transco Companies Inc.

2700 Post Oak Boulevard
P. O. Box 1396
Houston, Texas 77001
713-871-8000

August 19, 1982

Tomlinson Interests, Inc.
925 Houston Natural Gas Building
Houston, Texas 77002

Attention: Mr. Jim S. Denison

Re: Transco's Gas Purchase Agreement #06991—Newsom Field, Marion County, Mississippi (F. W. Willoughby 3-5 Well)

Gentlemen:

This is to advise you that effective immediately, Transcontinental Gas Pipe Line Corporation (Transco) requests that until further notice, gas deliveries from the subject well in the subject field operated by Tomlinson Interests, Inc., and committed under Transco's gas purchase agreement with Tomlinson Interests, Inc., Albert F. Thomasson, Burgess A. Thomasson, Viking Petroleum, Inc., Gasex, Ltd., Resources Investment Corp., Argo Petroleum, Horton Petroleum Corporation, Jack McCunn, Cameron L. Cox, Jack Spottswood and Charles G. Gates be reduced to contract minimum quantities as set out in Section 2 of Article V of the contract, attributable to the working interest committed to Transco.

Effective August 19, 1982 Transco will only take production attributable to the pro rata working interest of the above-named signatory parties as defined in Section 4 of

Article V, and until further notice will no longer accept any gas being sold by the operator under the operating agreement.

This action is being taken because the volume of gas which is currently available for delivery to Transco under its existing gas purchase agreements substantially exceeds the demand for gas in our market area. Also, the decline in oil and other fuel prices, coupled with increasing gas purchase costs, has resulted in the loss of some industrial market in the areas served by Transco's system. It is anticipated that this situation will result in additional market loss by certain of our distribution customers. Transco must, therefore, take measures such as this to reduce our takes in fields where we are currently taking more gas than is dedicated under contract. Similar notices containing this request have been given by Transco in all instances where permitted by contract.

Should you have any questions, please call Ms. Trisha S. Pollard at 713/871-2552.

Very truly yours,

TRANSCONTINENTAL GAS PIPE LINE CORPORATION

/s/ J. PHIL MCGOWAN, JR.
J. Phil McGowan, Jr.
Vice President – Gas Purchases

JPMc:TSP:jmf

cc: see attached list

[159] BY MR. TAYLOR:

Q. Mr. Ridgway, I believe that what has been marked as Exhibit 11 has attached to it a copy of a letter of August 19, 1982, from Transco to Tomlinson, is that correct? A. That is correct.

Q. And it references the Willoughby Well? A. Yes, it does.

Q. For the record, would you read the second paragraph on page 1 of the letter of August 19, 1982, from Transco to Tomlinson. A. (Reading) "Effective August 19, 1982, Transco will only take production attributable to the pro rata working interests of the above named signatory parties as defined in Section 4 of Article 5, and until further notice will no longer accept any gas being sold by the operator under the Operating Agreement."

Q. Are you one of the above named signatory parties that refers to? A. No, I am not.

Q. Are you in the category of a person whose gas was being being sold under the Operating Agreement? A. That is correct.

Q. Will you turn to the first page of Exhibit 11 and read the first sentence in the first paragraph? A. (Reading) "Attached for your information is a copy [160] of a letter dated August 19, 1982, from Transcontinental Gas Pipe Line Corporation wherein they notify Tomlinson Interests, Inc., operators of subject well, that effective August 19, 1982, they will only take production attributable to the pro rata working interest of those working interest owners who are signatories to that certain gas purchase contract dated April 15, 1982, between said owners and Transcontinental, and that until further notice they will not accept any gas being sold by Tomlinson Interests, Inc. under the Operating Agreement covering said well."

Q. It refers to a gas purchase contract of April 15, 1982, are you a party to that contract? A. No, I am not.

Q. That is the contract, which has been introduced and marked as Exhibit 6. Mr. Ridgway, after receiving the good news from Transco, what efforts did you make to obtain a market for your gas produced from these wells? A. After I had received——

Q. The notice that Transco proposed not to take your gas, what efforts, if any, did you make to obtain another market for your gas? A. I made an effort to check to see if there were other marekts in the field area and contacted the one that was the most prominent, appearing to be a possible market and that was Tennessee Gas, whose agent is Mr. Charles Wilkerson from Columbia, Mississippi.

[161] Q. Were you able to obtain another market for your gas? A. No, I was not.

Q. After this petition was filed, I believe you receive an offer from Transco to purchase your gas produced from the——

BY CHAIRMAN FANCHER:

Mr. Taylor, I hate to interrupt you, but I think you are getting way out of the area of Rule 48. Rule 48 says anybody purchasing gas or oil from a common source of supply shall purchase ratably and without discrimination. I don't know why we need to get into whether or not there is another market available.

BY MR. TAYLOR:

I'm just attempting to show for the record the good faith efforts my client has made to try to obtain another market.

BY CHAIRMAN FANCHER:

Okay, sir.

BY MR. TAYLOR:

Q. Now, Mr. Ridgway, after the petition was filed in this docket, Transco made an offer to you to buy your gas, didn't they? A. Yes, they did.

Q. I show you this letter of July 1, 1982, and ask you if you can identify it. [162] A. (Examines letter) Yes, I received a copy of this letter.

Q. It's from Transcontinental Pipe Line Corporation, is it not? A. Yes.

BY MR. TAYLOR:

Mr. Chairman, we would offer this into evidence as Exhibit 12.

BY CHAIRMAN FANCHER:

Mr. Stewart?

BY MR. STEWART:

No objection.

BY CHAIRMAN FANCHER:

All right, let it be marked.

(THE LETTER OF JULY 1, 1982, FROM TRANSCO TO COASTAL WAS MARKED AS EXHIBIT 12 TO THE TESTIMONY OF MR. RIDGWAY AND APPEARS AS FOLLOWS:)

Exhibit 12

Transcontinental Gas
Pipe Line Corporation

A Subsidiary of Transco Companies Inc.

2700 Post Oak Boulevard
P.O. Box 1396
Houston, Texas 77001
713-871-8000

July 1, 1982

Coastal Exploration, Inc.
P. O. Box 387
Jackson, Mississippi
–Attn: Mr. Julius Ridgway

TO ALL WORKING INTEREST OWNERS
IN GETTY OIL COMPANY - OPERATED
WELLS IN NEWSOM FIELD,
MARION COUNTY, MISSISSIPPI
BUCKLEY 33-6 No. 1
DAWSON 33-14 No. 1
ROGERS 28-11 No. 1
MORGAN 9-14 No. 1
SIPP 20-9 No. 2

Gentlemen:

You were advised by Getty Oil Company's (Getty) letter of June 17, 1982 that Transcontinental Gas Pipe Line Corporation (Transco) was, effective July 1, 1982, no longer accepting deliveries of gas being marketed by Getty, as operator under the operating agreement(s).

Getty's letter recommended that you make arrangements to contract your share of gas production, because your share would be deferred or under-produced effective July 1.

A number of you have contacted Transco requesting a contract under which to market your share of gas.

The volume of gas which is currently available for delivery to Transco under its existing gas purchase agreements substantially exceeds the demand for gas in Transco's market areas. Consequently, Transco is not currently submitting offers for deregulated gas without "market-out" clauses. However, it is not Transco's intention to leave the owners of small working interests without a market for its gas. Accordingly, Transco is offering to pay you, effective July 1, 1982 and until you are notified further, a price of $5.00 per MMBTU, inclusive of tax reimbursement and all other adjustments. If, in Transco's sole opinion, this price is later determined by Transco to be uneconomic, Transco has the right to notify you of such determination and of the economic price Transco is willing to pay you for the gas. The price contained in such notice shall be effective as of the date specified in the notice. Should you elect to terminate this agreement, you shall have up to, but not more than thirty (30) days from the date of our notice to notify Transco in writing of such election to terminate this agreement. If you elect to terminate within this thirty (30) day period, you shall have an additional sixty (60) day period from the date of your election, in which to effectuate sale of gas covered hereunder to another purchaser; after which sixty (60) day period this agreement is terminated. During the sixty (60) day period, Transco will pay you the price contained in its notification. In the event you elect to terminate this agreement, you agree that you will not sell to a third-party purchaser at a price equal to or less than the price contained in Transco's notification. You will have no obligation to refund any of the price received for your gas prior to termination of this agreement. If, under gas purchase agreements which contain similar provisions as the above, Transco should increase this price, the price under this agreement shall be increased accordingly.

This offer is being made subject to one condition. Transco requires that one (1) representative among you be appointed for purposes of receiving notices under this agreement.

The foregoing summarizes Transco's offer to purchase gas, regarding pricing. All other relevant terms and conditions affecting this sale and purchase of gas shall be in accordance with the Transco-Getty gas purchase agreement dated August 6, 1980, covering gas produced from the Newsom Field, Marion County, Mississippi, including but not limited to, provisions pertaining to quantity and quality.

If our offer is acceptable to you, and you desire to ratify the August 6, 1980 gas purchase agreement between Transco and Getty, please sign this letter in the space provided below, retain one (1) copy and return one (1) copy to Transco by August 31, 1982.

Should Transco's offer to purchase your gas not be acceptable to you, please be advised that Transco would be agreeable to entering into a transportation agreement with any third-party purchaser with whom you conclude an agreement for the disposition of your gas, so long as such third-party purchaser is operationally able to accept the gas from Transco's system, which operate at pressures somewhat lower than other pipelines. Further, such transportation would be at no cost, risk or expense to Transco, so long as capacity is available in Transco's system, and so long as such transportation does not involve a forward haul on Transco's main line system. Transco would transport this gas under the same quality specifications as are contained in its contract with Getty, which obligates Transco to accept gas from Getty containing up to 8% CO_2 from any given well, but an average from all of the Getty wells of no more than 6% CO_2. Should you elect to sell your gas to another purchaser, we would appreciate your notify-

ing us of those marketing arrangements, so that we can implement the transportation service.

Very truly yours,

TRANSCONTINENTAL GAS PIPE LINE CORPORATION

/s/ J. PHIL MCGOWAN, JR.
J. Phil McGowan, Jr.
Vice President – Gas Purchases

JPMc:TSP:lkk

ACCEPTED and AGREED to this

_____ day of _____, 1982

_____

COMPANY NAME (if any)

By _____

PLEASE PRINT OR TYPE THE NAME OF EACH SIGNATORY PARTY IMMEDIATELY BELOW EACH SIGNATURE.

[166] BY MR. TAYLOR:

Q. Mr. Ridgway, Exhibit 12 is dated July 1, 1982, did you receive it on or about that date? A. No, I received it on or about the first week in August.

Q. And I believe that it is addressed to the Sipp and Rogers Well that you own an interest in, as well as other Getty operated wells? A. That is correct.

Q. Did you receive another letter from Transco after this letter offering to buy your gas in the Willoughby Well? A. Yes, I did.

Q. I show you this letter dated September 2, 1982, and ask if you can identify that? A. (Examines letter) Yes, this is a copy of the letter I received.

Q. And it is on the letterhead of Transco? A. That's correct.

BY MR. TAYLOR:

Mr. Chairman, we would offer this into evidence as Exhibit 13.

BY CHAIRMAN FANCHER:

Hearing no objection, let it be marked

(THE LETTER OF SEPTEMBER 2, 1982, FROM TRANSCO TO COASTAL WAS MARKED AS EXHIBIT 13 TO THE TESTIMONY OF MR. RIDGWAY AND APPEARS AS FOLLOWS:)

Exhibit 13

Transcontinental Gas
Pipe Line Corporation

A Subsidiary of Transco Companies Inc.

2700 Post Oak Boulevard
P. O. Box 1396
Houston, Texas 77001
713-871-8000

September 2, 1982

TO: All Working Interest Owners in Tomlinson Interests, Inc. – Operated Well in Newsom Field, Marion County, Mississippi – Willoughby 3-5 No. 1

Gentlemen:

We understand you were advised by Tomlinson Interests, Inc. (Tomlinson) that Transcontinental Gas Pipe Line Corporation (Transco) was, effective August 19, 1982, no longer accepting deliveries of gas being marketed by Tomlinson that are not dedicated to Transco by contract.

The volume of gas which is currently available for delivery to Transco under its existing gas purchase agreements substantially exceeds the demand for gas in Transco's market areas. Consequently, Transco is not currently submitting offers for deregulated gas without "market-out" clauses. However, it is not Transco's intention to leave the owners of working interests in the subject well without a market for all of their gas. Therefore, Transco hereby offers to pay you, effective October 1, 1982 and until you are notified further, a price of $5.00 per MMBTU, inclusive of tax reimbursement and all other adjustments for all gas not presently committed or dedicated by contract. If, in Transco's sole opinion, this price is later determined by Transco to be uneconomic, Transco has the right to notify

you of such determination and of the economic price Transco is willing to pay you for the gas. The price contained in such notice shall be effective as of the date specified in the notice. In the event of such determination you have the right to elect to terminate this agreement. You shall have up to, but not more than thirty (30) days from the date of our notice to notify Transco in writing of such election to terminate this agreement. If you elect to terminate within this thirty (30) day period, you shall have an additional sixty (60) day period from the date of your election, in which to effectuate sale of gas covered hereunder to another purchaser; after which sixty (60) day period this agreement is terminated. During the sixty (60) day period, Transco will pay you the price contained in its notification. In the event you elect to terminate this agreement, you agree that you will not sell to a third-party purchaser at a price equal to or less than the price contained in Transco's notification. You will have no obligation to refund any of the price received for your gas prior to termination of this agreement. If, under gas purchase agreements which contain similar provisions as the above, Transco should increase this price, the price under this agreement shall be increased accordingly.

This offer to purchase your uncommitted gas is being made subject to one condition. Transco requires that one (1) representative among you to be appointed for purposes of receiving notices under this agreement.

The foregoing summarizes Transco's offer to purchase your uncommitted gas, regarding pricing. All other relevant terms and conditions affecting this sale and purchase of gas shall be in accordance with the Transco-Tomlinson gas purchase agreement dated April 15, 1982, covering gas produced from the Newsom Field, Marion County, Mississippi, including but not limited to, provisions pertaining to quantity and quality.

If our offer is acceptable to you, and you desire to ratify the above-described April 15, 1982 gas purchase agreement, as amended, for your uncommitted gas, please sign all three (3) copies of this letter in the space provided below, retain one (1) copy and return two (2) copies to Transco. THIS OFFER EXPIRES SEPTEMBER 30, 1982.

Should Transco's offer to purchase your gas not be acceptable to you, please be advised that Transco would be agreeable to entering into a transportation agreement with any third-party purchaser with whom you conclude an agreement for the disposition of your gas, so long as such third-party purchaser is operationally able to accept the gas from Transco's system, which operates at pressures somewhat lower than other pipelines. Further, such transportation would be at no cost, risk or expense to Transco, so long as capacity is available in Transco's system, and so long as such transportation does not involve a forward haul on Transco's main line system. Transco would transport this gas under the same quality specifications as are contained in its contract with Tomlinson which obligate Transco to accept gas from Tomlinson containing up to 8% CO_2 from any given well, but an average from Tomlinson's well(s) of no more than 6% CO_2. Should you elect to sell your gas to another purchaser, we would appreciate your notifying us of those marketing arrangements, so that we can implement the transportation service.

Very truly yours,

TRANSCONTINENTAL GAS PIPE LINE CORPORATION

/s/ J. PHIL MCGOWAN, JR.
J. Phil McGowan, Jr.
Vice President – Gas Purchases

JPM:QGG:nw

ACCEPTED and AGREED to this

____ day of _____, 1982

_____

COMPANY NAME (if any)

By _____

PLEASE PRINT OR TYPE THE NAME OF EACH SIGNATORY PARTY IMMEDIATELY BELOW EACH SIGNATURE.

[169] BY MR. TAYLOR:

Q. Mr. Ridgway, can you tell the Board your understanding of the offer made to you by Transco by Exhibits 12 and 13?

BY MR. STEWART:

Mr. Chairman, again, the letters speak for themselves.

BY CHAIRMAN FANCHER:

Well, it's a little argumentative, Mr. Stewart, but maybe he won't argue so long after the hearing if we let him kind of explain the contents in the letters.

BY MR. STEWART:

I just want equal time, that's all.

BY CHAIRMAN FANCHER:

Okay.

BY MR. TAYLOR:

Q. Mr. Ridgway, without reading the two letters word for word, would you tell the Board what your understanding is of the offer Transco made to you after this petition was filed? A. Well, my understanding is that they are making an offer which is substantially less than the price which I had been receiving from them by selling my gas through the operator under their contract. I was shocked by this discrimination that apparently they were meting out on the small working interest owners.

[170] Q. What differences, if any, are there in the price Transco proposes to pay you as opposed to the price paid to the operator? A. I believe that the price that Getty——

BY CHAIRMAN FANCHER:

You believe, or do you know, Mr. Ridgway?

A. I know, but I leave room for some doubt as to the percentage. It is about $7.90 a million for the gas we are receiving under the Getty contract. This contract, or this offer to purchase calls for $5.00 per million BTU.

Q. Are there any other differences in the basis on which they propose to buy your gas as opposed to the operator's? A. My understanding is that there is one primary difference in that any future contract would provide for the market out provision, which is not included in the Getty contract under which we have been selling.

Q. What do you mean by market out provision? A. The market out provision is a provision within the contract that enables the purchaser to arbitrarily roll back the price from the price at which they are purchasing to a price level at which they deem to be proper under the times and conditions.

Q. Mr. Ridgway, have you accepted the offer which Transco extended to you in Exhibits 12 and 13? A. No, I have not.

[171] Q. Why not? A. I believe I'm entitled to the same terms and conditions that I have been selling under the Getty contract.

Q. On the other wells that you own an interest in the Hosston trend, I believe you described them as 14 wells outside these four, on what basis is Transco purchasing the gas from those wells? A. They are purchasing my gas on the same terms and conditions that they purchase from the operator.

Q. What other times in which you have been involved in oil and gas business have you been involved in a situation where the gas purchaser offered different prices to different owners in the same wells? A. I believe this is the first occasion that I have run across of this nature.

Q. Mr. Ridgway, based on your study of the geology and the drainage patterns between the developed units, do you have an opinion as to whether Transco's failure to purchase your gas will result in nonuniform, disproportionate, or unratable withdrawals from the common pool which will cause undue drainage between developed tracts and which result in some owners recovering more than their fair and equitable share? Do you have an opinion? A. Yes, I do have an opinion.

Q. What is that opinion? A. I believe that—my opinion is that there is a disparity created when the condition that exists where the [172] Barnes 29-1, the Carlisle 4-2 and the Buckley 33-6, continue to produce at the maximum efficient rate and the wells which Coastal has an interest in that the production is going to be deferred, being the Rogers 28-11, the Sipp 20-9 Number 2, and the Willoughby 3-5 Number 1, if the production is reduced from these wells, that a disparity is created in relationship to the maximum efficient rate and which will cause drainage to occur and the waste that is connected with drainage. And because of this you will get disproportionate, nonuniform withdrawal, which will result in abuses to the rights of owners, such as Coastal, to market and share its part of the production which will deny us the right to get our just and equitable share of the production.

Q. You mentioned the Barnes Well, do you own an interest in the Florida-Barnes? A. Yes, I do.

Q. Has Transco proposed to take your share of gas produced from the Barnes Well? A. Yes.

Q. As well as all the other working interest owners? A. That's my understanding.

Q. And that would also be the situation for the Florida-Carlisle Well? A. That's correct.

Q. In your opinion will Transco's failure to take [173] your gas, your share of production from the Sipp, Rogers

and Willoughby Wells, result in the abuse of your correlative rights in the common pool? A. Yes, I believe that will occur.

Q. What effect, if any, will there be on the dissipation of reservoir energy and your opportunity to recover your share of gas? A. Well, Coastal, as the result of the dissipation of reservoir energy, will never be able to regain the lost pressure that occurred due to the continued production. And the reservoir energy or pressure will be dissipated to the owners of the banked or the deferred gas, as gas pressures normally decline with continued production. That will result in a nonuniform withdrawal from the common pool for the benefit of the operator and the signatory parties and to the disadvantage of the nonsignatory parties that will be having their gas deferred or left in the ground.

Q. Mr. Ridgway, in your opinion if Transco fails to take your share of gas or purchase it, will waste result? A. Yes, it will.

Q. It's your belief that Transco's proposal to buy your gas at $5.00 MMBTU is discriminatory in favor of the other owners and operators in the common pool? A. It definitely is.

BY MR. TAYLOR:

That's all of the questions we have of this witness.

• • • • • • • • • •

[200] CROSS EXAMINATION

BY MR. STEWART:

Q. Mr. Ridgway, when did you first find out that Transcontinental Gas Pipe Line Company was going to buy gas from Getty Oil Company in the Rogers, Sipp and Willoughby Wells? A. I don't know the actual time. It was by

virtue of a letter that I received from Getty as—at first I received a request from a representative of Getty to buy my production and I responded to that requesting certain information regarding that. Then I received a letter from Mr. Andrews indicating that they were entering into a gas purchase contract with Transcontinental and indicated a price.

Q. Would this be that letter? A. (Examines) This is the letter from Mr. Andrews, yes, dated July 9, 1980.

Q. That is over two years ago, is that correct? A. Yes, it is.

Q. Do you know in relationship to the drilling of these wells whether or not this was before any production from these wells that are located in this common source of supply? A. It was substantially before that.

Q. Did you receive a letter from Getty Oil Company shortly after this letter indicating that if you had not made your own arrangements with regard to the selling of your share of the gas that they would sell it for you under the terms and conditions of the Operating Agreement with respect to the [201] Rogers Well? A. Yes, I did.

Q. I'm going to ask you if this is a copy of that letter? A. This is a copy of one letter. I received two requests from Getty, one from one office and another one from another office.

Q. I think that is the wrong letter. Let me ask you if this is the letter. A. (Examines) That is one letter—I received this letter, yes.

Q. Did you reply to this letter with respect to the Rogers Well that you would be willing for them to sell your gas under the terms and conditions of the Operating Agreement? A. I believe I wrote them back and asked them to send me a copy of the gas purchase contract so that I might ascertain the terms and conditions of that contract and

indicated that I wanted them to sell my gas under that, subject to approval of it.

Q. This is Getty Oil Company? A. That is Getty Oil Company, right.

Q. And Getty sent you a copy of the contract? A. They did send me a copy of the contract.

• • • • • • • • • •

[211] BY MR. STEWART:

Q. Mr. Ridgway, referring you back to the letter of July 9, 1980, which you said was the first indication that you received that Transcontinental Gas Pipe Line would be purchasing Getty Oil Company—you did identify the receipt of that letter? A. Yes, and I'm not sure it was the first indication, but it was one of the earliest and I believe that was the correspondence that I received.

BY MR. TAYLOR:

May the record reflect that the petitioner, Coastal, has a continuing objection as to this line of inquiry and the documents that Mr. Stewart is handing to the witness.

BY CHAIRMAN FANCHER:

All right, sir.

BY MR. STEWART:

Let me introduce that as cross examination exhibit 1

BY CHAIRMAN FANCHER:

All right, let it be marked for the record.

(THE LETTER OF JULY 9, 1980, WAS MARKED AS EXHIBIT 1 TO THE CROSS EXAMINATION OF MR. RIDGWAY, FOR THE RECORD ONLY, AND APPEARS AS FOLLOWS:)

Exhibit 1

GETTY

Getty Oil Company

P.O. Box 53386, New Orleans, Louisiana 70153
Telephone (504) 524-4861

Southern Exploration and Production Division
J. P. Richards—Production Manager New Orleans District

July 9, 1980

Mr. Julius M. Ridgway
P. O. Box 367
Jackson, Mississippi 39205

Re: Gas Sales
Marion County, Mississippi

Dear Sir:

Getty Oil Company is presently negotiating a contract with Transcontinental Gas Pipeline Company for sale of gas from the Greens Creek—East Morgantown Fields. The contract should be executed within the next month.

Sales from the field should start in October, 1980. The price to be received for the gas will depend on inflation escalation factors. It is estimated that the price will be approximately $5.07 per MMBTU.

Yours very truly,

GETTY OIL COMPANY

/s/ H. R. Andrew
H. R. Andrew
District Prod. Mgr.

HRA/ngr

[213] BY MR. STEWART:

Q. What is the price reflected in that letter for the sale of gas at that time, Mr. Ridgway? A. It was recited as being in excess of $5.00, which was considerably above the price indicated by the other representative of Getty.

Q. This was $5.07 per MCF, is that correct? A. That's right.

Q. And all of your correspondence and communications with regard to the sale of this gas was with Getty Oil Company, was it no? A. Except for my first telephone inquiry with Transcontinental, trying to get a copy of the gas purchase agreement between Transco and Getty, and I was denied access to that contract and was told I would have to contact Getty for that.

Q. Transcontinental Gas Pipe Line did eventually send you a copy of that contract, did it not? A. I forget which one it was, but they requested I get approval from Getty before it was done.

Q. So, they didn't deny it, they asked that you get approval, did they not? A. Well, it was in a way a denial.

Q. And you did receive a copy, did you not? A. Yes. That's right, it was from Transcontinental.

Q. And it was sent to you from Transcontinental Gas Pipe Line Company, was it not? [214] A. Yes.

Q. And you did receive a copy, did you not? A. Yes, it was from Transcontinental.

Q. With the exception of that, the request for the copy of the contract, all of your communications were with Getty Oil Company with regard to the sale of your gas, was it not? A. That's right.

Q. And you did not ask Transco to contract with you to purchase your gas until in May or June of 1982 when you

asked to ratify the Getty contract? A. That's correct, neither did they request me to ratify or be a party to a contract.

• • • • • • • • • •

Excerpts from the testimony of Gerald Brautigam

[272] DIRECT EXAMINATION

BY MR. WATTERS:

Q. Would you please state your name and place of residence for the record? A. My name is Gerald Brautigam and I live in Kenner, Louisiana.

Q. By whom are you employed and in what capacity? A. I am employed by Getty Oil Company as a petroleum geologist.

Q. Have you previously testified before this Board as an expert in petroleum geology and were your qualifications accepted at that time? A. Yes, I have, and they were.

Q. Are you generally familiar with the Statewide Rules and the Special Field Rules for the Greens Creek Field and for the East Morgantown Field? A. Yes, I am.

BY MR. WATTERS:

I would like to submit the qualifications of Mr. Brautigam as an expert in petroleum geology.

BY CHAIRMAN FANCHER:

All right, let the record show the qualifications of Mr. Brautigam are accepted.

[273] Q. Have you made a study of the Greens Creek Field and East Morgantown Field in Jefferson Davis and Marion Counties, Mississippi? A. Yes, I have.

Q. Have you prepared or had prepared under your supervision and control any exhibits in connection with your testimony? A. Yes, I have prepared two exhibits. The first exhibit is a structure map contoured on top of the Harper Sand, that's for the Greens Creek and East Morgantown Fields. The second exhibit is a total sand isopach map of the Harper Sand for Greens Creek and East Morgantown Fields.

Q. Do these two exhibits accurately portray the matters which they purport to protray? A. Yes, they do.

BY MR. WATTERS:

I would like to introduce Exhibits 1 and 2 to the testimony of Mr. Brautigam.

BY CHAIRMAN FANCHER:

All right, sir, let them be marked.

• • • • • • • • • • •

[274] BY MR. WATTERS:

Q. Would you please refer to your first—by the way, we have a third exhibit in here but that will be introduced through our engineer later.

BY CHAIRMAN FANCHER:

All right, sir.

Q. (Mr. Watters) Would you please refer to your first exhibit and explain what is shown on that exhibit? A. My first exhibit is a structure map of Greens Creek and East Morgantown Fields contoured on top of the Harper Sand. As you can see in the legion the red squares show proposed well locations; the red half squares indicate currently drilling wells. The green circles indicate wells that are completed in the Harper Sand Gas Pool. And the green semi-circles indicate wells that have tested the Harper Sand Gas Pool but were not completed in that reservoir. The field outline for Greens Creek and East Morgantown Fields are indicated by the red and blue lines, respectively. The contour interval on this map is 100 feet. The scale is one inch equals 2,000 feet. Basically, this exhibit shows that Greens Creek and East Morgantown Fields are a group of structural highs located on the upthrown eastern side of a sinuous down to the west normal fault that trends generally north/northwest to south/southeast.

Closure of these structures, enclosure up against the fault, are the trapping mechanisms for the hydrocarbons that are produced at Greens Creek Field and East Morgantown Field.

[275] Q. Are the reservoir limits for the Harper Sand Gas pool depicted on this exhibit? A. Yes, they are. The western and southern limits of the Harper Sand Gas Pool are defined by the fault, which is depicted on this map as the parallel sinuous lines with a little black triangular symbols or teeth marks. These symbols indicate the down-thrown side of the fault. The northern and eastern limits of the Harper Sand Gas Pool are defined by a combination of gas/water contacts, lowest known gas levels and highest known water levels as seen in various wells throughout the fields. This is shown by the dashed black line production limit.

Q. Would you please refer now to your second exhibit and explain what is shown on this exhibit? A. The second exhibit is a sand isopach map of Greens Creek/East Morgantown Field Area. As on the previous exhibit, the red squares show proposed well locations, the red half squares show currently drilling wells. Here the green circles denote wells which were drilled through and electrically logged through the Harper Sand Gas Pool. Again, the red and blue lines show the field outline for Greens Creek and East Morgantown Fields respectively. The contour interval is 10 feet and the scale is one inch equals 2,000 feet. This exhibit shows that the Harper Sand is a continuous sand body throughout these two fields. Sand thickness in the two fields is generally [276] greater than 20 feet and commonly exceeds 40 feet. No shaleouts can be seen or evidenced.

Q. In your opinion is the Harper Sand Gas Pool, as seen in Greens Creek Field a part of the same reservoir as the Harper Sand Gas Pool as seen in East Morgantown Field? A. Yes, it is. Geological data show that the Harper Sand

is continuous across both fields. These data suggest that the Harper Sand Gas Pool, as seen in Greens Creek Field and the northern part of East Morgantown Field are actually a single reservoir. Due to an area of low porosity and permeability around the Getty Willoughby 3-11 Well, it is possible that the portion of the Harper Sand south of the Tomlinson Willoughby 3-5 Well is in a separate pool. In addition, the Tomlinson Morgan 21-10 Well and Tomlinson Thornhill Well are on a separate fault block, and therefore, in a separate reservoir from the rest of the East Morgantown wells.

Q. Referring again, Mr. Brautigam, to your first exhibit, which is the structure map, do you see any geological separation in the Harper Sand Gas Pool which separates the Getty Sipp 20-9, the Getty Rogers 28-11 and the Getty Buckley 33-6 Wells, and also, the Tomlinson Willoughby 3-5 Well as other wells completed in the Harper Sand Gas Pool? A. No, other than this area of low porosity and permeability south of the Tomlinson Willoughby 3-5 Well and the fault that separates the Tomlinson Morgan 21-10 Well and the Tomlinson Fortenberry Well. There is no geological evidence [277] separating the rest of these wells in Greens Creek and East Morgantown Field.

Q. In other words, there is no geological feature which would prevent the Harkins Board of Supervisors 16-11 Well in Section 16, the Tomlinson Williamson Well in Section 21, the Florida Exploration Barnes 29-1 Well in Section 29, the Florida Exploration Carlisle 4-2 Well and other wells in the Harper Sand Gas Pool from draining hydrocarbons under the three Getty wells and the Tomlinson Willoughby 3-5 Well in the event the latter wells do not produce in sufficient volumes to offset drainage? A. That is correct. If the three Getty wells and the Tomlinson Willoughby well are not produced at all, in time the other wells that are completed in the pool would significantly drain the unit in which these wells are located. If the production from these four wells is lower than the production

in the surrounding wells to an extent that drainage is not offset by counter-drainage, then these wells will not produce their coequal and correlative share of hydrocarbons from the Harper Sand Gas Pool reservoir.

Q. What do you think is necessary for these wells to produce a share which will enable them to recover sufficient production to protect their coequal and correlative rights of all parties owning an interest in these wells?

Well, in my opinion ratable production based on [278] deliverability is necessary. In other words, if the other wells in the pool are producing at their maximum efficient rate of recovery, then these four wells should also be permitted to produce at their maximum efficient rate of recovery to prevent drainage.

Q. At what depth is the Harper Sand Gas Pool encountered in the Getty Wells? A. As you can see on this Exhibit 1, I have the structure tops on this. It's encountered below a depth of 15,000 feet.

Q. Have these wells been classified as Section 107 wells under the Natural Gas Policy Act of 1978? A. Yes, they have, according to my information.

Q. Do you know whether the other wells shown on your structural exhibit have been classified as Section 107 wells? A. Again, as you can see on Exhibit 1, I have indicated the depth that each well has encountered the Harper Sand Gas Pool. As you can see, all these depths are below 15,000 feet, and accordingly, are entitled to classification as a Section 107 high cost well. It's my information that each of these wells has been classified before this Board as a 107 well.

Q. In your opinion if Transco is not required to take ratably from all wells in the field, would the coequal and correlative rights of all parties owning an interest in this field be protected? A. In my opinion it will not. Without

ratable [279] production there will be undue drainage between the units. As a result, the owners of interests in this units which are subject to this drainage will not be able to receive their fair share of hydrocarbons from the Harper Sand Gas Pool.

• • • • • • • • • •

Excerpts from the testimony of James L. Hall

[279]

JAMES L. HALL

Having first been duly sworn by the Chairman, gave the following testimony:

DIRECT EXAMINATION

BY MR. WATTERS:

Q. Would you please state your name and place of residence? A. My name is James L. Hall. I reside in Kenner, Louisiana.

Q. By whom are you employed and in what capacity? A. I'm employed by Getty Oil Company as a reservoir engineer.

Q. Have you previously testified before this Board as an expert in reservoir engineering and were your qualifications accepted at that time? [280] A. Yes, I have, and they were accepted.

Q. Are you generally familiar with the Statewide Field Rules and the Special Field Rules for Greens Creek Field and East Morgantown Field? A. Yes, I am.

BY MR. WATTERS:

I would like to submit the qualifications for Mr. Hall as an expert in reservoir engineering.

BY CHAIRMAN FANCHER:

Let the record show the qualifications of Mr. Hall are accepted.

Q. (Mr. Watters) Have you made a study of the Greens Creek and East Morgantown Fields in Jefferson Davis and Marion Counties, Mississippi? A. Yes, I have.

• • • • • • • • • •

[284] Q. From a study of this reservoir, is it your opinion that there is communication between the wells in the Harper Sand Gas Pool in the Greens Creek Field and the Harper Sand Gas Pool in the northern portion of East Morgantown Field? A. Yes, that is my opinion; however, there is insufficient evidence to show that wells in the lower East [285] Morgantown Field are drained by wells in Greens Creek or the northern portion of the East Morgantown Field, meaning the following wells: the Buckley 33-6, the Florida Exploration-Carlisle 4-2, or the Tomlinson Willoughby 3-5.

Q. Is it your opinion if one well were produced in this pool they would cause drainage from the whole pool? A. That is my opinion.

Q. Is it your opinion that if one well produced at its maximum and efficient rate and another well produced below its maximum efficient rate, that the well producing at a higher rate will drain more than its fair share of hydrocarbons from the pool than a well producing at the lower rate? A. In my opinion that will result.

Q. Will the coequal and correlative rights of the owners of interest in a unit in the Greens Creek Field, which is producing at a rate substantially below its MER, receive their fair share of hydrocarbons in a pool if a well on an adjoining tract is producing at a rate near its maximum efficient rate of recovery? A. No, in my opinion they will not, because in this situation there will be undue drainage from the under-produced units to the unit which is producing near its maximum efficiency rate of recovery. In this situation the coequal and correlative rights of the parties in the lower producing unit will not be protected.

[286] Q. Do you recommend that the Board enter an order requiring the purchaser to purchase ratably from all wells in the field? A. Yes, I do. I think this is necessary

to protect the coequal and correlative rights of all parties in the field.

BY MR. WATTERS:

That's all the questions we have.

CROSS EXAMINATION

BY MR. GROWER:

Q. Do you know how many purchasers there are in this area that you have outlined to be all one pool? A. How many purchasers? No, I do not.

Q. If there is more than one purchaser, do you require that all purchasers be required to take ratably?

BY MR. FRANKS:

We object to the question as not being responsive to the petition in this cause which is to determine whether Transco is taking ratably or not without discrimination. If others are not taking ratably, it's possible they might be before this Board, too, but on a subsequent hearing and not today.

BY CHAIRMAN FANCHER:

I have sort of half way taken that position in the past, Mr. Franks, but the way this question was phrased, I think Mr. Grower is entitled to ask that question. There may be some competition between purchasers down there, but still at the [287] same time if somebody is unhappy with the conduct of other purchasers, then they can drag them before the Board.

BY MR. FRANKS:

I don't think that Transco can use what other purchasers are doing as an excuse for not taking ratably without discrimination of the petitioner in this cause. I think they are trying to throw a smoke screen up to the Board so that they can hide what they are doing by what somebody else might be doing, and we object to it for that reason.

BY CHAIRMAN FANCHER:

Well, I'm not so much subject to a smoke screen, Mr. Franks. I think we will let him ask the question.

BY THE WITNESS:

Would you repeat the question?

BY MR. GROWER:

Q. Is it your recommendation that all purchasers in the field should be required to take ratably? A. I would say the wells should be produced ratably.

Q. The wells should be produced ratably—that is what your recommendation really is, is that right? A. That's correct.

Q. Then that can be regulated by the Board by requiring the producers to produce ratably, can't it? A. That's right.

BY CHAIRMAN FANCHER:

How can we do that, Mr. Grower, without field wide unitization?

[288] BY MR. WATTERS:

He is asking a legal question of the witness.

BY CHAIRMAN FANCHER:

Yes, sir, I think so.

BY MR. STEWART:

Mr. Chairman, he just gave his opinion about a legal conclusion.

BY MR. FRANKS:

Mr. Chairman, the Board is under legislative mandate to fix the takes of wells at the maximum efficient rate of each well.

BY MR. GROWER:

Do you want to get into that legal argument now?

BY CHAIRMAN FANCHER:

We will do it later, Mr. Grower.

BY MR. GROWER:

Q. Mr. Hall, if only one purchaser takes ratably, is that going to solve the problem of the drainage? A. Drainage will occur if there is a greater offtake from one well than the others.

Q. Right. Now, the producers can produce the wells at the rate that the market can take the gas, can they not?

BY CHAIRMAN FANCHER:

Now, Mr. Grower, as I understand it, we are not supposed to consider market demand in making any decisions that we make.

[289] BY MR. FRANKS:

That's correct.

BY MR. GROWER:

Well, do you want to get into that argument now?

BY CHAIRMAN FANCHER:

No, sir.

BY MR. FRANKS:

We object to any questions relating to market demand as it might be concerning takes in wells.

BY MR. GROWER:

Q. Well, if the market cannot take the gas, what is it going to do with it, Mr. Hall?

BY MR. WALLER:

That's not for the Board to decide, Mr. Chairman.

BY CHAIRMAN FANCHER:

I agree with that, Mr. Waller. You might go talk to the legislature about that, Mr. Grower.

BY MR. GROWER:

You keep wanting to prompt me into arguing that point, which I will be happy to do if you wish.

BY CHAIRMAN FANCHER:

We will do it later.

Q. (Mr. Grower) Mr. Hall, I hand you Mr. Wilbur Knight's Exhibit 3, which is the production history from these wells. Are you familiar with all those production statistics from these wells? [290] A. Yes, I'm familiar with the wells.

Q. Before the market was reduced and the purchaser, Transco in this case, determined it could not produce any more gas from nonsignatory parties, prior to that time were these wells ratably produced by the operators? A. They were ratably produced, I would say, yes.

Q. You say that's ratable production? A. Based on their well capacity to produce, yes.

Q. Was there any drainage caused by that ratable production? A. There was drainage being—in which wells now?

Q. The wells that produced the greatest amount of gas. A. Yes, there would be drainage there.

Q. Was the Rogers Well draining from other wells in that same reservoir? A. Apparently, at these high rates it would be draining, yes.

Q. And you say they were being produced—even though they were being produced ratably there was drainage? A. There was drainage, yes.

Q. Are you familiar with the allowables for the Getty-Rogers and the Getty-Buckley Wells? A. I have seen their deliverability, yes.

Q. Are you familiar with what the allowables have [291] been for those wells as set by order of the Board? A. As best I recall—now, this is my opinion, that the wells are capable of producing in excess of what they are producing—the rates shown here.

Q. Are you saying you don't know what the allowables were? A. I'm saying what the deliverabilities——

Q. I didn't understand you. Are you saying you know what the allowables were? A. I will look.

Q. All right. A. Are you ready for me to finish now?

BY MR. WATTERS:

Mr. Chairman, I would like to object to this line of questioning. He is asking questions about production from the past and whether or not past production has resulted in drainage. That's immaterial to this issue before the Board. The issue before the Board at this time is whether or not the failure to take ratably does not protect the coequal and correlative rights of all parties in the pool. That is the point to which is testimony is directed. What has happened in the past when there was no limitations on the ratable take is immaterial to this matter before the Board at this time.

BY CHAIRMAN FANCHER:

Well, as I recall it, the Petitioner introduced this [292] exhibit. He is cross examining him on it. He is asking him about allowables and whether he knows what they are or not. So far he has said he knows what the deliverability is, and I think we will allow him to continue.

BY MR. WATTERS:

The line of questioning is directed to past operations though.

BY CHAIRMAN FANCHER:

Well, this exhibit goes all the way back to April of 1981, Mr. Watters.

BY MR. WATTERS:

That's the Petitioner's exhibit?

BY CHAIRMAN FANCHER:

Yes, and that's what he is referring to.

BY MR. WATTERS:

I still would object to it being not material.

BY CHAIRMAN FANCHER:

Okay, your objection is noted.

A. (The Witness) I would not know what the allowables were back prior to—I have one of the date of September 1, 1982, showing the deliverability of—gas deliverability tests for these wells.

Q. (Mr. Grower) You are not familiar with the allowables? A. No, not back in these prior years.

[293] BY MR. GROWER:

I think that's all the questions we have.

• • • • • • • • • •

Excerpts from the testimony of Ray Corcoran

DIRECT EXAMINATION

BY MR. WATTERS:

Q. Would you state your name and place of residence? A. My name is Ray Corcoran, and my business address is P. O. Box 1404, Houston, Texas. I'm a natural gas activities manager for Getty Oil Company.

Q. Would you briefly describe your business background? A. I graduated from West Texas State University in 1969, with a Bachelor of Science Degree. Between 1965 and 1972, I was employed by Phillips Petroleum Company in Amarillo, Texas with various marketing positions. In 1972 I was transferred to Corpus Christi in the marketing department. In 1976 I transferred to the gas and gas liquids department for Phillips Petroleum Company in Houston, Texas. My primary responsibility included negotiating gas sales and purchase agreements for [294] the Southern Division office. In 1978 I was promoted to gas sales specialist. I resigned from Phillips Petroleum Company effective January 1, 1981. In January of 1981 I accepted the position of natural gas manager for Getty Oil Company.

Q. Are you familiar with the petition filed by Coastal Exploration to require Transcontinental Gas Pipe Line to take ratably? A. Yes, I am.

Q. Are you familiar with the gas sales contracts in Greens Creek Field and East Morgantown Field Area? A. Yes, of course, I am very familiar with the gas sales contracts which Getty Oil Company has with Transco dated August 6, 1981. I have examined the gas sales contracts between Harkins Company and Transco dated December 12, 1978. I have examined the gas sales contracts between Tomlinson Interests, Inc., Transco Exploration Company, ABI Properties, Marline 78 Company U.S.A., as seller and

Transco as purchaser dated July 6, 1979, covering certain lands in the East Morgantown Field. I have examined the gas sales contracts between Tomlinson Interests, Inc. and Transco dated September 5, 1978, covering lands in the Greens Creek Field. I have also examined the gas sales contract between Florida Exploration and Transco dated August 22, 1980. I am generally familiar with other contract in the area.

Q. Have you prepared any exhibits in connection with your testimony today? [295] A. Yes, I have prepared——

BY CHAIRMAN FANCHER:

Now, Mr. Watters, let me stop you just a minute. If you intend to get into all of these contracts, it's real nice to know he is familiar with them, but we don't want any testimony about what the contracts are.

BY MR. WATTERS:

What he has is four contracts, and I think it will show that Transco is obligated to purchaser near or full capacity from each well covered by those contracts.

BY CHAIRMAN FANCHER:

Well, now, that's not the question before this Board. That's a matter for the courts. If they are in violation of the contract, that's not our problem. The question is: are they taking ratably and without discrimination.

BY MR. WATTERS:

And that would depend upon what their contract obligations are.

BY CHAIRMAN FANCHER:

No, sir. No, sir, not at all. If they have contractual obligations, then you go down on Pascagoula Street, that is the place for you to go, or some place else.

BY MR. WATTERS:

Could we for the purpose of the record ask about seven or eight questions dealing with this?

[296] BY CHAIRMAN FANCHER:

You want to make proffer?

BY MR. WATTERS:

Yes, Sir.

BY CHAIRMAN FANCHER:

Very cautiously, yes, sir.

BY MR. WATTERS:

We will have to do it through introducing his exhibit that shows the gas contracts.

BY CHAIRMAN FANCHER:

Let any exhibits be offered for identification and make any proffer of testimony that you would like to.

BY MR. WATTERS:

Let's see, I have offered for evidence, and I guess you are admitting it and I'm making a proffer testimony, is that correct?

BY CHAIRMAN FANCHER:

That's correct. It may be marked for identification.

(THE EXHIBIT OF OVERLAYS OF GREENSCREEK FIELD AND EAST MORGANTOWN FIELD WAS MARKED AS EXHIBIT 1 TO THE TESTIMONY OF MR. CORCORAN AND APPEARS AS FOLLOWS, FOR PURPOSES OF THE RECORD ONLY)[1]

---

[1] The contracts referred to by Mr. Corcoran were subsequently introduced into the Record but have not been made a part of the Joint Appendix.

R 19 W

T 5 N

T 4 N

"GREENS CREEK"

JEFFERSON DAVIS CO

MARION CO

"NEWSOM"

"E. MORGANTOWN"

"S. MORGANTOWN"

RIVER

Ext. 1 contra I.D.

GREENS CREEK FIELD
TOMLINSON INTERESTS, INC

NEWSOM FIELD
FLORIDA EXPLORATION COMPANY

EAST MORGANTOWN FIELD
TOMLINSON INTERESTS INC. et al

GREENS CREEK FIELD AREA
HARKINS AND COMPANY et al

Getty Oil Company
MAP OF
EAST & SOUTH MORGANTOWN,
GREENS CREEK & NEWSOM FIELDS
JEFFERSON DAVIS & MARION COS. MISSISSIPPI

JA-101

[297] BY MR. WATTERS:

Q. Would you please explain what is shown on this exhibit? A. This exhibit covers the Greens Creek Field and and East Morgantown Field. The first overlay in red indicates the area dedicated by Tomlinson Interests, Inc. to Transco under its agreement dated September 5, 1978. The overlay colored in blue is that area dedicated by Florida Exploration Company to Transco under its agreement dated August 22, 1980. The overlay colored in green is that area dedicated by Tomlinson Interests, Inc., Transco Exploration Company, ABI and Marlin 78 Company to Transco dated July 6, 1979. The overlay in yellow shows the area dedicated to Transco under its contract with Harkins, dated December 12, 1978. The area on the black sheet that is outlined in heavy black lines indicates the area dedicated by Getty to Transco by agreement dated August 6, 1980.

Q. What quantity of gas is Transco obligated to take or pay for under the terms of the Harkins agreement, which is indicated in yellow on the map? A. Transco is obligated to take any quantities of gas well gas tendered by Harkins, provided such quantities do not exceed 10 million cubic feet per day per completion.

Q. What quantity of gas is Transco obligated to take or pay for under the Tomlinson September 5, 1978 contract, which is shown in red on this map?

[298] BY MR. STEWART:

Mr. Chairman, we are going to object to this line of testimony. Mr. Corcoran isn't a party to those contracts. Those contracts are not in evidence, and they would be the primary evidence.

BY CHAIRMAN FANCHER:

Yes, sir, we have already held that the testimony is not admissible. He just wants to put it into the record.

BY MR. WATTERS:

Q. What quantity of gas is Transco obligated to take or pay for under the Tomlinson September 5, 1978 contract, which is shown in red on this map? A. Transco is obligated to take or pay for, if not taken, any quantity of gas well gas tendered by Tomlinson provided such quantity shall not exceed seller's interest in 10 million cubic feet per day per completion.

Q. What quantity of gas is Transco obligated to take or pay for under the terms of the Florida Exploration contract, which is colored in blue on this plat? A. Transco is obligated to take or pay for, if not taken, the amount of gas equal to 85 percent of Florida Exploration's working interest ownership percentage in any gas which Florida Exploration may have available for delivery as the results of an Operating Agreement.

Q. What amount of gas is Transco obligated to take or pay for under the Tomlinson et al contract dated July 6, 1979, [299] which is shown in green on this map? A. Transco is obligated to take or pay for 90 percent of deliverability from all sources of gas.

Q. In other words, under these gas sales agreements, Transco is obligated to take or pay for all or substantially all of the gas produced by wells operated by these parties, is that correct? A. Yes, it is.

Q. How does the take or pay provisions in these gas sales contracts compare with the take or pay provisions of the gas sales contract which Getty Oil Company has with Transco dated August 6, 1980? A. It's substantially different. In Getty's gas sales contract Transco is not obligated to purchase all of the gas available to Getty or the gas from the common pool. Transco is only obligated to take Getty's pro rata share of the production in each unit.

Q. The petition filed in this matter indicates that Transco has purchased from the date of first production in all well

listed in the petition all the production from said wells until on or before July 1, 1982, is that correct? A. Yes, it is. The three wells mentioned in the petition which are operated by Getty, are the Rogers 28-11, the Sipp 20-9, and the Buckley 33-6. In all of these wells Transco has purchased all of the gas produced, even though it was not [300] obligated to do so insofar as gas sales contracts are concerned. Transco now advises that it will only purchase the share of gas that it is obligated to purchase under its gas sales contracts.

Q. According to your records, what share of gas is that? A. Okay, in the Getty Oil Company-Rogers 28-11 Well, Transco has the commitment to purchase gas from the parties owning a 45 percent interest. Tennessee has a contract to purchase gas from parties owning a 2 percent interest; however, at this time Tennessee Pipe Line is not connected to the Getty wells. According to our information, the remaining ownership in the wells, namely 53 percent, is uncommitted. In the Sipp 20-9 Well Transco is obligated to take gas from the owners of 70 percent interest. Nine percent is committed to Tennessee, and the remaining 21 percent is undedicated gas. In the Getty-Buckley 33-6 Well, Transco is obligated to take from owners of 80 percent interest. Tennessee, when its pipeline is completed, is obligated to take gas from the owners of 11 percenter interest. The remaining nine percent is owned by parties without gas sales contracts.

Q. Has Transco contacted you, as operator of these wells, concerning the amount of gas which they will take in the future? A. Yes, they have. They have advised us that they will only take the minimum contract quantity of gas which it [301] has committed to them under contract.

Q. In other words, the Rogers 28-11 Well, it has indicated it will only take 37 percent of the amount that the well was capable of delivering, and from the Sipp 20-9, it will take only 59 percent of the gas that it's capable of

delivering, and for the Buckley 33-6 it will take only 70 percent of the gas which the well is capable of delivering?

BY MR. STEWART:

Object to the form of the question.

BY CHAIRMAN FANCHER:

I think that may be a little bit leading.

BY MR. WATTERS:

It was, I agree. I was trying to save time. I'll do it the other way.

Q. Are you familiar with the percentage of interest which Transco will take in the Rogers 28-11 Well, the Sipp 20-9 Well, and the Buckley 33-6 Well? A. Yes.

Q. What percentage of the total interest in those wells has Transco indicated they will take? A. By our figures that we have worked up with calculations, we come up with 37 percent of the amount of gas capable of delivering for the Sipp 20-9 Will, 59 percent, and for the Buckley 33-6, approximately 70 percent interest. Now, these figures were arrived at by taking the dedicated interest [302] under contract times the contract minimum.

Q. What is your understanding with reference to Tomlinson as operator of the Willoughby 3-5 Well in Section 3? Have you been advised whether or not Transco has told them they would only take committed gas in that unit? A. Yes, I have received a copy of the correspondence stating that.

Q. What is that share? A. By my calculations it would be approximately 43 percent.

Q. Is the gas purchased from the Tomlinson Willoughby 3-5 Well subject to the Getty contract or the other Tomlinson contract? A. The Tomlinson Willoughby Well is

subject to the Getty contract because the acreage was farmed out from Getty.

Q. According to your information, has a similar notice been sent for Harkins, Florida Exploration and Tomlinson with reference to wells that they operate under the four gas sales contracts which are reflected on your exhibit? A. According to my information there has not. Under these gas sales contracts, Transco is obligated to take virtually all of the gas produced under the wells, and accordingly, they are not refusing to take any gas from them. However, I understand Transco has mailed a letter asking for "voluntarily" cut.

Q. Referring to your map, which wells will continue [303] to be produced at or near delivery capacity? A. As far as the Harkins is concerned, its Board of Supervisors 16-11 Well in Greens Creek and its colored in yellow on the plat, would still be producing at its delivery capacity. The Tomlinson Williamson Well in Section 21, which also produces from the Harper Sand Gas Pool, is covered by one of these contracts, and also would produce at delivery capacity. The Florida Exploration Carlisle 4-2 Well in Section 4, Township 4 North, Range 19 West, and the Florida Exploration Barnes 29-1 Well in Section 29, Township 5 North, Range 19 West, will continue to produce at delivered capacity. The Tomlinson well in East Morgantown covered by the green area, such as, the Tomlinson Beacham in Section 11, the Tomlinson Board of Education in Section 16, the Tomlinson Petard in Section 15, the Tomlinson Thornhill in Section 22, will all still produce at delivered capacity.

Q. Have you heard the previous testimony concerning the continuity of Harper Sand Gas Pool between these fields and the fact that one well will cause drainage from the Harper Sand Gas Pool? A. Yes, I have.

Q. In your opinion what would be the affect of disproportionate withdrawals from these wells, which you referred to by Transco? A. The wells which are producing at full deliverability, will be draining those wells producing at less than [304] full deliverability. This will be detrimental to owners of interest in units operated by Getty and the Tomlinson Willoughby Well which is covered by the Getty contract.

Q. In your opinion will this protect the coequal and correlative rights of all owners in the pool? A. No, it will not, because the owners in the underproduced units will not recover their fair and equitable share of hydrocarbons in the pool.

Q. Will this unratable withdrawal also constitute waste as defined in the Mississippi Conservation Statute? A. In my opinion it will.

Q. Does Getty have gas balancing agreements in its Operating Agreements in these fields? A. No, we do not.

Q. Does Getty purchase Coastal's gas, or does it deliver it to Transco? A. We strictly deliver the gas under the terms of the Operating Agreement.

BY MR. WATTERS:

That's all the questions we have.

CROSS EXAMINATION

BY MR. STEWART:

Q. In your Exhibit 1, I believe it is, you have shown various contract areas with regard to contracts that you have reviewed between other parties as well as Getty Oil Company with Transcontinental, is that correct? [305] A. Yes.

Q. Exactly what do these contracts dedicate to Trans-

continental as far as a commitment to continue to produce and deliver gas to Transcontinental Gas Pipe Line?

BY CHAIRMAN FANCHER:

Mr. Stewart, you objected to the introduction of this testimony, we sustained the objection and he made proffer. Are you cross examining him on proffer?

BY MR. STEWART:

Yes, sir, I certainly reserve my objection, but if it has been offered under proffer, I certainly think we are entitled to cross examine.

BY CHAIRMAN FANCHER:

All right, sir.

Q. (Mr. Stewart) In all of these contracts exactly what is dedicated to Transcontinental Gas Pipe Line Company as far as a commitment to continue to deliver gas to Transcontinental? A. As we have previously stated, it varies in each contract.

Q. When Getty, or when any other party enters into a gas contract with Transcontinental Gas Pipe Line, are they committing for a certain period of time to delivery anyone else's gas from those wells? A. In some contracts, yes. There is a special reference in one of the agreements.

[306] Q. This is your interpretation? A. This is my interpretation, right.

Q. Did Getty commit to or dedicate to Transcontinental anyone else's share of gas over the term of that contract? A. We dedicated our pro rata working interest in each unit with some additions during certain periods of the year.

Q. Why didn't Getty dedicate every one else's gas under that contract? A. I did not negotiate the contract at that time.

Q. What is the term of Getty's contract with Transcontinental Gas Pipe Line Company? A. Fifteen years from date of first delivery.

Q. That's a fairly ordinary term for gas purchase contracts, is it not? A. It's not—there is no standard form. There are some regulations that require this, but it cannot be considered as standard.

Q. There is no standard term. Terms are, generally in this area, all in excess of 10 years, are they not? A. I think so, yes.

Q. You have indicated that in your opinion wells which are required to under produce from their maximum efficient rate of production, or from what they can produce, are going to be drained by those wells which are producing at their maximum efficient rate of flow, is that correct? A. Yes.

[307] Q. The Getty Rogers and the Getty Buckley Wells all have deliverability in excess of every other well around them, do they not? A. We have recently completed the deliverability test and I'm not familiar with the other deliverability tests.

Q. You do not know what the Sipp deliverability test is? A. The Getty operated wells I'm well familiar with the deliverability tests, but the other operated wells, I do not know.

Q. Assume that the Getty operated wells have a deliverability potential in excess of every other well produced in and around those wells in the Greens Creek and East Morgantown Area, then is it not true that even though the Getty wells may be under produced if they are not under produced to the extent that that production rate is lower than the other producing wells, then there is no drainage, is there?

BY MR. FRANKS:

We object to the question calling for a legal conclusion on the part of the witness, Mr. Chairman. The issue is whether those wells are being allowed to produce at the maximum efficient rate. Nobody ever said that all wells will produce from the pool at the same rate and that all wells have the same identical amount of hydrocarbons underlying the unit assigned to them. The issue is that if they are producing at the maximum efficient rate, which in this instance would be their [308] deliverability test, then they are being produced ratably. And the issue we have here today is whether because of the failure of Transco to purchase ratably as to whether these wells can be produced ratably or not.

BY MR. STEWART:

Mr. Chairman, I think that a substantial issue before this Board is what is ratable production? Mr. Franks has certainly got an opinion of it and I think that my opinion differs from it. Mr. Corcoran has indicated that there is drainage and I'm simply trying to cross examine Mr. Corcoran as to the basis of his statement and I think that I am entitled to do that.

BY CHAIRMAN FANCHER:

Well, I'm not sure, Mr. Franks, that the question calls for a legal conclusion. I think it calls for a conclusion of an expert in petroleum engineering, and I don't recall Mr. Corcoran having been qualified as anything except a gas purchaser agent for Getty. So, I sustain the objection on that basis.

Q. (Mr. Stewart) Mr. Corcoran, if the Getty wells have a deliverability in excess of their allowables as created by the State Oil and Gas Board, does Getty still produce at its deliverability? A. I didn't understand part of your question.

Q. If the Getty wells have a deliverability that are in excess of the allowables as granted by the Oil and Gas [309] Board, does Getty still deliver at its deliverability? A. I suppose I will show my expertise here, but I was under the understanding that the allowable was set by the deliverability.

Q. Assume that an allowable has been set and a subsequent deliverability test shows that your deliverability is greater than the allowable, which does Getty produce at?

BY MR. WALLER:

Mr. Chairman, that doesn't have anything to do with this hearing.

BY CHAIRMAN FANCHER:

I can't see that it does either, Mr. Stewart.

BY MR. FRANKS:

We object to the assumption of such an issue.

BY CHAIRMAN FANCHER:

We fix allowables every six months based on deliverability and let's not be assuming that they are more or they are less than the deliverability tests.

BY MR. STEWART:

Q. You have given the Board some figures based on your investigation as to what interest is committed under the gas contract for the Getty wells and what remains uncommitted. In your investigation did you include the interest of non-signatory parties who have within the last month agreed to commit their gas and sell their gas to Transco under the outstanding offer? [310] A. Yes, that was included in the calculations.

Q. You have also investigated contracts covering the entire Greens Creek and East Morgantown Fields, is that

correct? A. Not the entire fields, just these particular ones that I have mentioned. I know there are many, many.

Q. Are the prices that are being paid under these various contracts the same? A. The prices vary in different areas.

Q. They vary by contract, do they not? A. Yes.

Q. Does Getty—do the signatory parties to Transco contracts in Getty operated wells receive the same prices? A. Through July they have received the same prices.

Q. All signatory parties in the Getty operated wells? A. No.

Q. That's my question: do signatory parties—do parties who own interests in Getty operated wells and who have contracts with Transco, do they receive the same prices for their gas? A. The signature parties receive different prices, but all of the nonsignatory parties through July have received the same price.

Q. These are parties that have no contract to sell their gas? A. Yes.

[311] Q. The interest of these parties is uncommitted to any pipeline, is that correct? A. That's correct.

Q. And at any time they could sell their gas to a pipeline giving them the best offer, is that correct? A. Yes, that's my understanding.

Q. On the other hand signatory parties have committed their gas for an extended period of time to that one particular pipeline, have they not? A. Yes.

Q. And that is part of the negotiation process in entering into an agreement, is it not? A. Yes.

Q. How does Getty deliver gas to Transcontinental Gas Pipe Line from the wells that are the subject of this petition? A. I am not in the production department, I do not work in the field, I have never been in the field, but it's my

understanding we deliver through a central facility located in Section 33.

Q. You deliver an amount of gas from all of your wells to Transcontinental Gas Pipe Line, is that correct? A. Yes.

Q. Who allocates the total production stream that is sold to Transco back to the various wells? [312] A. I can't answer that question, I assume it to be——

BY MR. WATTERS:

I object to this line of questioning. I can't see that it has any relevancy to ratable take.

BY CHAIRMAN FANCHER:

I sustain the objection. I don't think it does either.

BY MR. STEWART:

Mr. Chairman, I'm still under a proffer, I assume.

BY MR. FRANKS:

Even under proffer you are subject to the rules of evidence. Same objection.

BY CHAIRMAN FANCHER:

I just can't see who allocates production back to these various wells has anything to do with it, Mr. Stewart. I mean, whether it's Jim Jones and John Smith, you know.

BY MR. STEWART:

That's my point.

Q. Who allocates production among the various wells in each well to the various interest owners in those wells?

BY MR. FRANKS:

We have the same objection.

BY CHAIRMAN FANCHER:

I think he has already stated he didn't know, Mr. Stewart.

Q. (Mr. Stewart) Does Transcontinental Gas Pipe Line Company allocate production among the various intesest owners in the Getty operated wells? [313] A. No.

BY MR. STEWART:

That's all I have.

EXAMINATION

BY MR. TAYLOR:

Q. You have heard testimony that Transco has offered Coastal $5.00 for its share of gas produced in the Sipp and Rogers wells. Do you recall hearing that testimony? A. Yes.

Q. Will you tell the Board what price Getty is receiving for its share of gas produced from the Rogers and the Sipp wells? A. Getty is receiving $7.907 per MMBTU, plus full tax reimbursement.

Q. How long will that price be in effect? A. I believe until January 1, 1983, or the date that we request a price redetermination.

BY MR. STEWART:

Mr. Chairman, we are going to object to this line of testimony. It's been sustained all morning and afternoon.

BY CHAIRMAN FANCHER:

Yes, sir, I wondered when you were going to object. I sustain the objection.

BY MR. TAYLOR:

Mr. Chairman, we offer this testimony for the purpose of showing that the prices offered to Coastal are discrimi-

natory [314] in favor of the operator and other owners of the pool, which gets right to Rule 48.

BY MR. STEWART:

That's the only issue, Mr. Chairman, the price.

BY MR. TAYLOR:

I couldn't agree more and that's what I'm asking the witness about.

BY CHAIRMAN FANCHER:

I think it has been well established, what the price—$7.93 to Getty and Coastal has been offered $5.00 I don't think we need to hear that again.

BY MR. TAYLOR:

Yes, sir.

Q. (Mr. Taylor) Mr. Corcoran, you are familiar, you testified that you are familiar with the maximum efficient rate of flow from the Getty Sipp and the Getty Rogers Wells, is that your testimony? A. Yes.

Q. Will Transco's proposal not to take the gas of non-signatory parties, like Coastal in those wells, result in the wells not producing at their maximum efficient rate of flow? A. Yes.

Q. In your opinion will waste result because of that? A. Yes.

BY MR. TAYLOR:

Mr. Chairman, that's all the questions we have.

[315] BY MR. WALLER:

I have one question.

BY CHAIRMAN FANCHER:

All right, Mr. Waller.

EXAMINATION

BY MR. WALLER:

Q. In the Rogers Well, or any of the wells surrounding that area, who has a gas transportation pipeline hooked up so that the working interest owners might sell their ratable share of the gas being produced? A. At the present time I do not know of another purchaser that is connected to our wells.

Q. So, if Transco doesn't take the gas, is it possible for any price to sell the gas as the system is now established? A. Unless it was transported by Transco.

BY MR. WALLER:

That's all I have.

BY CHAIRMAN FANCHER:

Any other questions?

FURTHER CROSS EXAMINATION

BY MR. STEWART:

Q. Mr. Corcoran, Transco in its letter to the nonsignatory parties has offered to transport it to another pipeline, has it not? A. Yes.

Excerpts from the testimony of Trisha Pollard

DIRECT EXAMINATION

• • • • • • • • • •

[321] Q. (Mr. Stewart) With respect to the Harper Sand Gas Pool, how many different contracts does Transco have in these two fields? A. Approximately 35.

Q. Do you have an exhibit indicating the number of contracts and the contractual parties of these contracts that affect the Harper Sand Gas Pool in these two fields?

BY MR. FRANKS:

Mr. Chairman, Getty has just offered an exhibit and [322] testimony regarding contracts by parties with Transco in this field and in the Harper Sand Gas Pool, and the Board would not allow the introduction of that testimony except by proffer. I think that is, again, Transco trying to do the same thing that the Board denied Getty the right to do, and I think an objection to this type testimony should be sustained. How many gas contracts they have got, or where they are, and who they are with, is not the relevant issue here and the Board has just ruled that Getty couldn't introduce similar type testimony except under proffer.

BY CHAIRMAN FANCHER:

I agree with you, Mr. Franks.

BY MR. STEWART:

Mr. Chairman, they have constantly stated that the issue before this Board is whether or not Transco has purchased ratably and without discrimination. How do you purchase without a contract? I simply say that what we are trying to demonstrate is the present status of the purchasing situation in these two fields and to the extent that is affected by the current market situation. And it certainly is relevant in the Board's making any determination on pur-

chasing ratably without discrimination. If the Board sustains it, we will proffer it into the record, but in our opinion it should not be sustained.

• • • • • • • • • •

[323] BY MR. STEWART:

Mr. Chairman, my objection was not based on irrelevancy. It was based on the fact that a person who was not a party to that contract was interpreting the contract for provisions that were not before this Board, which the contracts themselves are the primary evidence.

BY MR. FRANKS:

Mr. Chairman, this is a rather simple hearing that Mr. Stewart is trying to make complicated. We have got a petitioner here, Coastal. Transco has said, "We art not going to take your gas," first, and later they come up and say, "We will take it, but we are not going to pay you what we are paying your operator for." That's the issue, is whether they are going to take Coastal gas ratably without discrimination or not. That's the issue, and to bring in another thousand contracts or 50 contracts, or whatever, is irrelevant to what this petitioner and the relief they are seeking here, is that their gas be purchased ratably without discrimination.

BY MR. STEWART:

Mr. Chairman, why is it irrelevant that under the very same wells that Getty has a contract with, there are 12 other contracts and there are 35 other contracts covering the same pool that all have different terms and conditions, and payments, quantities, quality, everything is between the producer and the [324] pipeline has been up until this day a matter of contract, regardless of where that gas has been produced or by whom it has been produced. Now they want to limit this Board's investigation to just one contract, when Transco doesn't look at the Getty contract

as the contract in this field; it's one of 35. Our position simply is: why can the petitioners here ask this Board to force terms and conditions in one contract when there are 35 others with different terms and conditions? If the Board has got to determine what terms and conditions it's going to require, how can it make any kind of decision and determination at all if it doesn't know what terms and conditions of the contract exists.

BY CHAIRMAN FANCHER:

That's the whole point, Mr. Stewart, as far as I'm concerned. We don't intend to dictate terms and conditions of contracts.

BY MR. FRANKS:

And we don't want you to.

BY MR. STEWART:

Mr. Chairman, we move that the petition be dismissed because it is undisputed that the petitioner has currently got a market for its gas. He can sell his gas under the terms and conditions that have been offered to him, and if he can get better terms and conditions, Transcontinental will transport that gas to that other purchaser.

[325] BY CHAIRMAN FANCHER:

All right, you moved to dismiss. I will overrule that objection—your motion. Mr. Stewart, you don't plan to go into the terms of all of these 35 contracts, do you?

BY MR. STEWART:

No, sir, they will be made a part of the record though.

BY MR. FRANKS:

To which we will object.

BY CHAIRMAN FANCHER:

Yes, sir, I knew you would. Go ahead, Mr. Stewart, for the purposes of the record, you may proceed.

BY MR. FRANKS:

Mr. Chairman, may we have a continuing objection to any testimony regarding any other contracts that they have with other parties that are not a party to this hearing?

BY CHAIRMAN FANCHER:

Yes, sir.

BY MR. STEWART:

Q. Ms. Pollard, have you prepared an exhibit identifying particular contracts that Transco has with various interest owners in the Greens Creek and East Morgantown Fields? A. Yes, I have.

BY MR. STEWART:

I would introduce this as Exhibit 1 to Ms. Pollard's testimony.

BY MR. FRANKS: Mr. Chairman, we would object to any contract [326] involved in any wells other than the six that are at issue here, because the production from those six wells, or nonproduction from those six wells, are the only ones that are being charged as not being purchased ratably without discrimination and we don't think we need to go into any other areas other than those six wells.

BY CHAIRMAN FANCHER:

I sustain that objection, Mr. Stewart:

BY MR. STEWART:

There is apparently a dispute in the geological testimony as to where the Harper Sand Gas Pools lie. It's already been testified to that all of these contracts cover production from the Harper Sand Gas Pool. We submit that it is just

as relevant as the six wells that the petition has apparently arbitrarily named in their petition.

BY CHAIRMAN FANCHER:

Mr. Stewart, I still think—of course, I don't know what we are supposed to do with Rule 48. Here we are arguing about whether or not somebody is supposed to comply with Rule 48. It seems to me that whether we have a hearing about it or not, they are supposed to comply with it. And whether they are or not, would seem to me to be a matter with which this Board is really not equipped to handle. All we can do is determine whether you are or whether you are not. And I don't know what we can do about it if you are not. But anyway, let's limit the [327] testimony to these six wells that are the subject of this petition.

BY MR. STEWART:

Q. Ms. Pollard, I ask you to look at Exhibit 1, and can you identify which contract in this list of 35 contract that cover the Harper Sand Gas Pool in East Morgantown and Greens Creek Field are contracts under which Transcontinental, Inc. is purchasing production from the six wells named in Coastal's petition? A. Transco is purchasing gas from the six wells in the petition under contract marked by asterisks on Exhibit 1.

Q. How many contracts are shown on that exhibit that production is produced under and purchased from these six wells? A. There are 12 contracts.

BY MR. STEWART:

I introduce this as Exhibit 1 to her testimony. In conjunction with that, Mr. Chairman, I would submit the 12 gas purchase contracts that are asterisked also as Exhibit 1.

BY CHAIRMAN FANCHER:

All right, as we have done before, let them be marked for the purpose of the record only.

(THE LIST OF CONTRACTS AND ASTERISKED CONTRACTS WERE MARKED AS EXHIBIT 1 TO THE TESTIMONY OF MS. POLLARD, AND APPEAR AS FOLLOWS:)

[330] Q. Do the contracts that Transco entered into with various producers cover fields as defined by the State Oil and Gas Board? A. Usually not, because when a producer approaches us to market his gas to us under a gas purchase agreement, he typically has discovered one well and assigns a name to a field area, which may or may not be later adopted by the Board. The name that the Board adopts from the field may include a larger area than what is committed, a smaller area, or that name may not appear on the Board's designation of fields at all.

Q. Do the areas dedicated under these various contracts—these 12 contracts that you have identified in your Exhibit 1—generally correspond to East Morgantown and Greens Creek Fields? A. Generally, although some of the contracts cover what is called Newsom Field. • • •

• • • • • • • • • • •

[335] BY MR. STEWART:

Q. What exactly does Transco purchase when it makes a contract with a producer? A. We purchase the seller's working interest in leases under which he has mineral interests, as well as any fee interest that he has in any acreage.

Q. Does Transco approach the operator, and is Transco able to contract with the operator to dedicate interests that the operator does not own in any wells? A. No, a person can only sell what he owns. The fact that the producer may be an operator, generally, has no bearing on our contracting practices. When we begin to buy his gas in Mississippi and it was apparent that there were so many working

interest owners in each of the wells, we approached several ways of getting the working interest of every owner under commitment to us, because that was how we preferably would like to be able to do it. We had several attempts by our own legal department, I believe, also with outside counsel. And, in fact, even undertook a campaign of asking people, just independents and other people who produce gas in Mississippi, if there was any way that they knew of that we could get these interests under contract.

BY MR. FRANKS:

We object to hearsay, Mr. Chairman—talking about what other people said and who they conferred with—that's all hearsay. What does she know about it?

[336] BY CHAIRMAN FANCHER:

I sustain the objection, Mr. Franks. I don't think the Board is interested in the manner in which Transco or anybody else did about negotiating contracts.

BY MR. STEWART:

Q. What factors are important to the pipeline company in negotiating a contract? A. There are several factors—

BY MR. FRANKS:

We object to the question as not being relevant to this hearing as to whether they are going to take Coastal's gas and purchase it ratably without discrimination.

BY MR. TAYLOR:

Mr. Chairman, may the record reflect that the petitioner, Coastal, has a continuing objection to this line of inquiry?

BY CHAIRMAN FANCHER:

Yes, sir. I don't think it's material, Mr. Stewart.

BY MR. STEWART:

Q. Ms. Pollard, referring back to Exhibit 1, are the terms and conditions in these contracts the same? A. No.

Q. Are these contracts negotiated with—are they all negotiated with operators of various wells in these fields? A. Not with operators, no. The exhibit shows—the first column shows the contract number placed on it by our internal numbering system. The second column shows the date [337] tht the contract was entered into, and the third column marked "Seller" shows the name of the entity willing to commit its gas under a contract to us.

Q. What factors are used by Transco to determine the terms and conditions in which it is willing to enter into a contract for the sale of gas? A. The amount of reserves that the producer has proven up, the amount of the deliverability, the takes that would be negotiated into the contract. Obviously, the price at which we would take the gas, and the condition of our market has played an extremely important role in the past several years in determining whether we enter into contracts and under what terms.

BY MR. FRANKS:

Mr. Chairman, we object to this line of testimony. This Board cannot require Transco or any other pipeline to purchase gas from the Harper Sand Gas Pool. But they came in and said, "We want to buy gas from this pool." Once they commit and say, "We are buying gas from this pool," from that point on, Rule 48 says that they may not favor one person over another in the common source of supply. The testimony has shown that they are favoring one other another; that is Getty as operator signatory party, over Coastal as a nonsignatory party, who wants them to take their gas ratably at the same price. And to not do so favors Getty over Coastal. That's the only issue. We didn't say no one required them to buy gas in this

field, but once [338] they started buying it in this pool, those are the criteria, Mr. Chairman. It's the Board's criteria under Rule 48, not Transco's criteria.

BY MR. GROWER:

If the Board please, we think that is Mr. Franks' criteria, because we think that we need to show that there are many things that go into the obligation of the pipeline company to purchase gas. The market conditions are one of the major ones. The market conditions affect what they can pay for gas today, not what was contracted two or three years ago. They are talking about contracting to sell us gas today, not two or three years ago. And there is a big difference. What they want to do is pick out the contract with the biggest price entered into two or three years ago and say, "You have got to buy our gas for that today." So, we say that's ridiculous. They didn't offer to sell us that gas two years ago. They have been selling it to us under that price, but they didn't have to sell us that gas. If somebody came along and offered them twice as much they would have jerked it away from us in a second. Now that the price has gone down, they want to make us pay it under the highest contract when that's not the price today. That's not the market today. We say the present market conditions are something this Board has got to take into consideration—not what they were two or three years. You pick out one contract and say, "That's the only thing you can testify about. [339] You can't testify about any of these other contracts, because that one has got the best price and that's the one we want, and the best conditions." So, you make us take what contract they want. That's all there is to this case and that's not right.

BY MR. FRANKS:

That's not it at all, Mr. Chairman, members of the Board. Transco has been here for several years. They had

their gas contracts. They entered into a course of conduct relative to all of these six wells as to how they were going to purchase gas and whose gas they were going to purchase and what price they were going to pay for it. That course of conduct led Coastal to sell under its operator's contract at that same price. Transco knew this. This is no mystery to Transco about whose gas they were buying. They knew that they had been taking Coastal's gas and they knew that they had been paying Getty for that gas to be transmitted to Coastal. As Getty testified, "We only delivered gas." Transco bought Coastal's gas and they acted only as agents to collect the money to pay it to Coastal. They know what has been going on all the time. They say it's our prerogative to determine. Here's what they really get down to: it's our prerogative to determine at any time whether we will or will not take and purchase ratably without discrimination. And it's not Transco's prerogative; it's this Board's prerogative.

BY CHAIRMAN FANCHER:

You know, that objection led to a lot of discussion way [340] outside the scope of the question. I think the question was: what considerations are involved in executing a contract by Transco. That may constitute y'all's final argument in this case, I'm not sure about that. But anyway, I sustain the objection, because I don't think that Transco's considerations in adopting contracts are at issue here.

• • • • • • • • • •

BY CHAIRMAN FANCHER:

Before we proceed let me ask one question. Are there any other gas purchasers besides Transco from the six wells in question here?

BY MR. STEWART:

Yes, sir.

[341] BY MR. TAYLOR: Not that are taking the gas.

BY MR. STEWART:

They have bought the gas; they have a contract to buy it. Whether or not they are taking it is another question. We understood that they were hooked up.

BY MR. FRANKS:

Well, that's hearsay.

BY MR. WALLER:

I believe the record is, Mr. Chairman, that Tennessee went in and signed some contracts with some of the minor working interest owners in some of these wells. But they have not completed a gathering system and nobody has sold any gas since the inception of production in these six wells to any purchaser but Transco as of this date.

BY CHAIRMAN FANCHER:

All right, go ahead, Mr. Stewart.

BY MR. TERRELL:

There is gas contracted in these wells to take, or at least under the Tomlinson-Willoughby Well.

• • • • • • • • • • •

[344] Q. Would you explain to the Board very briefly why the prices are all different under contracts for production from the same wells? A. Prices are solely a matter of negotiation. These prices being paid for the deep gas are generally redetermined prices under contracts that allow the seller to select different options to determine his price. And to the extent that a seller selects a different option from another, or selects at a different time than another, or the contract contains some other clause that would allow the price to be even different than what the redetermination had said, or the contract contains a market out provision that would affect the price being paid.

[345] Q. Are these redetermination clauses the same in every contract? A. No.

Q. Which of these contracts has a market out clause? A. The last two contracts shown on Exhibit 3, both of them with Sabine Production Company. The one on December 1, 1981, covers Sabine's interest in the Greens Creek Field, and the one dated January 1, 1982, covers Sabine's interest in the Newsom Field.

Q. Would you explain to the Board what a market out clause is? That term has been bandied about, but let's try to make sure the Board understands what it is. A. Yes, it's a provision sometimes called an economic out which allows a pipeline purchaser to reduce the price that he is paying to the producer/seller under a gas purchase contract. If in buyer's sole discretion the gas being purchased is at prices which buyer's customers are not willing to pay because they can get alternative fuels at cheaper prices, the buyer generally notifies the seller of the price that he can pay and still be able to sell the gas on the other end of his customer, and seller can then either accept the price or he has the right to cancel the contract insofar as he sells his gas then for a price in excess of the price that the buyer offered him.

Q. Why don't all of the contracts in these fields have a market out clause in them? [346] A. Basically, because of the time that the contracts were entered into. Market out provisions are a fairly new phenomenon in interstate gas purchase contracts due to the passage of the Natural Gas Policy Act of 1978. Prior to that time the only gas which interstate gas pipelines could purchase was price regulated gas and which had been kept at artificially low prices; and therefore, we had no problem in being able to sell as much as we possibly could to our customers. The case is not true in intrastate market. I don't know in the case about Mississippi, but for instance, in Texas you had a very strong intrastate market which could purchase gas at prices that were not controlled—that were not regu-

lated. The market out or economic out provisions had been contained in intrastate contracts for a number of years.

Q. Did Transco institute a policy of requiring market out clauses on any gas purchase contracts that it entered into? A. At the time we began seeing that we may have a problem in marketing the gas that we were purchasing from producers under price deregulated contracts, we instituted a policy that any new contracts that we executed, the negotiations for that contract were entered into after February 1981, had to contain a market out.

Q. Now, you indicated that all of these contracts have what is called a redetermination clause, is that true also of the two contracts with Sabine Production Company? [347] A. Yes; just because the contract contains a market out provision doesn't mean that it does not also contain a redetermination provision.

Q. Does a redetermination allow the pipeline company to initiate negotiations to lower the price of gas? A. No.

Q. As a practical matter when a redetermination is exercised by a seller under the redetermination clause, does the redetermination result in lower prices? A. It can, and sometimes to the embarrassment of the producer, but the producer is required under the terms of his contract, if he wants to exercise his option to redetermine, he can. It's not mandatory in most of the older contracts, but if he does, once he does, he must stick with the option he has selected. If he has selected an option and all the facts are not in on what will make up that price and later the price is determined to be lower than what he had earlier been receiving, then, yes, his price will go down. And it has in some instances in these contracts.

Q. As a general rule though, will redetermined price go up or go down? A. Well, as a general rule it goes up.

Q. Do either one of the contracts with Sabine Production Company under which Transco is currently paying

$5.00, cover any production from the Rogers, Sipp or Willoughby wells? [348] A. Yes. The next to the last contract covers Greens Creek, which would, I believe, cover Sabine's interest in the Sipp 20-9. No, I'm sorry, it does not. The Greens Creek contract executed in December of 1981 by Sabine, covered Sabine's interest in the Rogers 28-11 Well, as well as some Greens Creek proper wells, such as, Williamson, Nelson, Stringer and Hathorne. And the Sabine contract executed in January of 1982 covers Sabine's interest in the Buckley, Dawson and Carlisle 1 and 2 Wells.

Q. So, Sabine Production, under its contract with Transcontinental Gas Pipe Line Company is receiving $5.00 per MMBTU for all of the wells under those contracts, is that correct? A. Yes, and that is inclusive of taxes.

Q. Does Transco have a gas purchase contract with either Coastal Exploration or the Fairchilds? A. No, we do not covering these wells. • • •

• • • • • • • • • • •

[349] Q. Has Transco ever received an offer from these people to place their minerals under contract? A. Yes, we entered into extensive negotiations with Inexco approximately a year to a year and one-half ago, and negotiations went over a period of time and ended with a refusal by Inexco to sell their gas to us.

[350] Q. With regard to the wells that are operated by Getty Oil Company in this field, how does Transco take gas from these wells? A. In the Getty gas purchase agreement the point of delivery which specifies where title passes from seller to buyer, provided that a point of delivery would be, one, at a central point in the field at a tailgate of a central facility; two wellhead connections when requested by seller; or three, any conbination thereof. We take delivery from all gas in all Getty wells at the tailgate of a central

facility that Getty has constructed that is located by the Buckley Well shown by a triangle on Exhibit 2.

Q. How is the gas allocated back to each well in the Getty gathering system and then back to each owner under each well? A. Getty allocates all production from all of their wells, and we receive monthly allocation statements from Getty.

Q. Do these allocation statements indicate who is receiving proceeds for the gas? A. I don't believe they do.

Q. Does Transco have any information—is any information provided to Transco by Getty Oil Company with regard to whether or not nonsignatory parties are selling their gas or whether or not gas is being banked? A. No. I don't believe so.

[355] BY MR. STEWART:

Q. Ms. Pollard, are you aware of owners in these six wells and the surrounding wells in the East Morgantown and Greens Creek Field that have sold or have dedicated their gas to another pipeline company? A. Yes, we are.

Q. What is the name of that pipeline company?

BY MR. FRANKS:

We object to the question as being irrelevant and immaterial to the issue involved in this case. This case is to determine whether Transco is purchasing ratably without discrimination or not and it doesn't have anything to do with what any other pipeline company is or is not doing.

BY CHAIRMAN FANCHER:

I sustain the objection. I think that's right, Mr. Stewart.

BY MR. STEWART:

Mr. Chairman, how can Transco purchase all of the gas ratably without discrimination from a pool if it's being sold or it's dedicated to another pipeline company?

BY MR. FRANKS:

It doesn't say it has to. It says it has to offer to, Mr. Chairman.

BY CHAIRMAN FANCHER:

I sustain the objection. I don't think we are interested in what other pipelines are doing.

• • • • • • • • • •

[367] [EXAMINATION BY MR. TAYLOR]

Q. But in fact, during that period of time Transco knew that it was buying the gas of nonsignatory parties, didn't it? You may not have known the identity of the people, but you knew that you were buying gas from nonsignatory parties. A. We knew we were buying gas in excess of Getty and Tomlinson's working interests percentages.

Q. And therefore, you knew it was gas attributable to nonsignatory parties. A. That is correct.

Q. That was the reason in your letter of May 15, 1982, to Getty you said, "We are no longer going to buy the gas of nonsignatoy parties."? A. Yes.

Q. And you helped prepare that letter, didn't you? A. Yes, May 19.

Q. I believe that Mr. Stewart asked you some questions about the exhibit on which you represent the September 1982 prices being paid. A. Yes.

Q. And you have listed the two contracts executed by Sabine at $5.00, is that right? A. That's correct.

Q. The fact is that Sabine owns no interest in the Getty-Sipp Well that Coastal owns an interest in, do they? A. I don't believe that Sabine owns an interest in the Sipp Well.

[368] Q. And their interest in the Rogers is less than one percent, isn't it? A. I don't know. I don't see what difference it makes.

Q. Well, the list of contracts you have listed here do not list the April 1982 ratification between Tomlinson and Transco under which Tomlinson is getting $7.90 for their gas produced in the Willoughby; you don't list that contract, do you? A. That's true, we don't.

Q. Referring to your exhibit in which you list the September 1982 prices, with the exception of the two Sabine contracts at $5.00, the price you are paying Getty is in effect the lowest price you are paying under the contract to these different people who own an interest in the six wells, isn't it? A. No, that's not correct. The first one lists Tomlinson Interests, which is receiving $6.51.

Q. Not in the Willoughby Well though. A. I thought you said the six wells.

Q. That's right, the Willoughby Well is one of the six wells producing from the common pool. Tomlinson is not receiving $6.50 for its share of gas produced from the Willoughby Well that Coastal owns an interest in, is it? A. No, that's true.

Q. They are receiving $7.90, or thereabouts? A. Right.

[369] Q. Now, Mr. Stewart asked you, and you testified that Transco, to paraphrase your words, only purchases the seller's working interest under the Transco contract, do you recall testimony to that effect? A. Yes.

Q. But that, in fact, is not true in certain of the wells completed into the Harper Sand Gas Pool in Greens Creek, is it? A. That is true, that is not correct. As a general rule that is the case. Where that general rule is modified by contract, then that's not the case.

Q. And factually, Transco is taking, for all practical purposes, the deliverability capacity of the Harkins wells

in Greens Creek completed into what the Getty geologist testified as a pool common with the Harper Sand Gas Pool; Transco is taking deliverability capacity from those wells? A. Deliverability capacity, is that what you said?

Q. Yes. Let me rephrase it, if you are having trouble with that. In the Harkins wells completed into this same pool, according to the Getty geologist, is Transco refusing to take the gas of any nonsignatory parties to the contract between Harkins and Transco? A. No, I don't believe we are.

Q. So, that as to the Harkins wells Transco is not proposing to cut those wells back to only the interest of the [370] signatory parties? A. That's correct.

Q. Meaning that if Transco cut back the Getty wells to only the interest of the signatory parties, but continues to take all of the gas produced from the Harkins wells, regardless of whether it's the gas of the signatory parties, there will be disproportionate withdrawals of gas as between the wells; yes, or no? A. Yes.

BY MR. TAYLOR:

Mr. Chairman, that's all the questions we have.

• • • • • • • • • •

[380] CROSS EXAMINATION

BY MR. WATTERS:

Q. Would you please refer to the exhibit which you introduced? A. Yes.

Q. You show a well here, which is the Tomlinson Williamson Well in Section 21, Township 5 North, Range 19 West. Do you see that on your plat? A. Yes, I do.

Q. Actually, this plat doesn't show the—yes, that's the well. All right, did you write Tomlinson as operator of

[381] of that well indicating you would only purchase from that well from the nonsignatory parties? A. No, I did not.

Q. In other words, you are still purchasing gas from that well as you have in the past? A. That is correct.

Q. Referring to the Florida Gas-Barnes Well in Section 29, Township 5 North, Range 19 West, did you write Florida Exploration, operator of that well, and tell them that you would only purchase gas from signatory parties? A. Yes, we did under a letter dated May 19, 1982.

Q. And what is your contractual obligation under that well? A. We were, subsequently to that letter, notified by Florida that under the terms of their contract we were obligated to take all the gas they tendered under the Operating Agreement. We, obviously, sent that letter out in error and agreed with their interpretation of the contract.

Q. So, you are continuing to take the full stream from that well, is that correct? A. That is correct.

Q. Would that also be true of the other Florida Exploration well, which is the Carlisle 4-2? A. Yes, that is correct.

Q. With reference to the ratification that you testified to, have you accepted those ratifications yet, or are you [382] holding them in abeyance pending appointment of seller's representatives? A. We are presently holding them in abeyance. However, I think when we begin to receive the Tomlinson responses we would have no reason to hold them, since Tomlinson has indicated a willingness to act as seller's representative.

Q. If this Board does not enter an order directing Transco to take ratably, will you refuse to purchase the nonsignatory interests in the Getty wells and in the Tomlinson Willoughby Well? A. I have never refused to purchase it; I have offered a market.

Q. At $5.00? A. That is correct.

Q. But unless they are willing to sell at $5.00, you will refuse to take their gas, is that your position? A. That is correct.

BY MR. WATTERS:

That's all the questions we have.

BY CHAIRMAN FANCHER:

Any redirect, Mr. Stewart?

REDIRECT EXAMINATION

BY MR. STEWART:

Q. Mr. Taylor indicated that—asked you some questions about what Transco purchases under contracts that it has. You indicated that I had made a mis-statement with regard to Transco [383] purchasing gas under the Operating Agreement. When Transco enters into a contract with a specific seller, what is dedicated to Transco under that contract? A. A producer sells to us that which he owns, which is his interest in mineral leases that he has gotten from the mineral interest owners, as well as any fee acreage that the producer may have in acreage.

Q. This is dedicated under the terms of the contract, is that correct? A. Yes.

Q. Now, to the extent that that seller can also deliver to Transco, either in quantities in excess of his interest or quantities that are owned by other parties what factors are involved in Transco's decision of whether or not to purchase that gas? A. Well, that's purely a matter of negotiation as it was in the Florida agreement.

BY MR. TAYLOR:

Mr. Chairman, we renew our objection to this line of questioning.

BY CHAIRMAN FANCHER:

I think Transco's policies, Mr. Stewart, as to the negotiation of contracts is entirely irrelevant and immaterial. We have been through that before.

Q. (Mr. Stewart) Is gas sold under an Operating [381] Agreement dedicated to Transco for the term of the contract? A. No. Even in the contract where we have the obligation to accept delivery of gas that is being sold under the Operating Agreement, that is one-sided on the producer's part. We have the obligation to accept the gas, but if at any time those producers who are selling under the Operating Agreement should decide to market their gas with someone else, it's gone.

Q. So that when you purchase gas that was not dedicated to you under a contract, it's like purchasing on the spot market, is that correct? A. That's correct. We cannot use those reserves for purposes of securing financing or entering into the economics of whether it's economic to lay the pipeline—anything of that nature. Because it's gas, the authority under which it is being sold is revocable under the Operating Agreement.

Q. Mr. Watters asked you some questions with regard to what quantities of gas you are currently taking from the J. C. Williamson Well operated by Tomlinson, and the two wells operated by Florida, I believe the Carlisle and the Barnes Well. Has Transco curtailed the quantity of gas they are taking from those wells? A. We requested Florida under the May 19th letter, to reduce the quantities being delivered to us to the contract minimum quantities as set out in the contract.

Q. Is Transco currently taking quantities of gas [385] dedicated to Tennessee Gas Pipe Line Company from those wells? A. Yes, we are.

Q. Did Transco, in fact, reduce the quantities from those wells from the full allowable to the minimum contract

quantities required that it be taking? A. It's my understanding that we did.

BY MR. FRANKS:

She had stated earlier she didn't know what the take was, Mr. Chairman, now she has reconsidered and now knows.

BY MR. TAYLOR:

Mr. Chairman, we move to strike the last line of questioning on the grounds of lack of firsthand knowledge.

BY MR. FRANKS:

She said before she didn't know what the take was.

BY CHAIRMAN FANCHER:

That's true, but that's argumentative, and, Mr. Stewart, I don't know why somebody didn't object, but that was improper redirect, in my opinion.

BY MR. STEWART:

Yes, sir, I'm just trying to clear up some questions. That's all we have.

BY CHAIRMAN FANCHER:

Okay. Let me ask you a question. When Transco enters into a gas purchase contract, are they aware of the Rule 48? A. Yes, sir, when we contract to buy gas in any state, we buy it subject to the rules in the state. Just like when we [386] sent out the letter requesting that the operators cut back to only the gas which was under contract to us.

BY CHAIRMAN FANCHER:

Q. Yes, that's all very good, but what about ratable take without discrimination? When you come in here to purchase gas, don't you realize that your contract is subject, and that your purchasing and your distribution and sale of gas, is subject to Rule 48? If the rule is any good it's

part of your contract, isn't it? Or at least your operations are subject to it, are they not? A. That's correct.

BY CHAIRMAN FANCHER:

Thank you.

• • • • • • • • • •

Excerpts from the testimony of Claude Mullendore

[388]

CLAUDE H. MULLENDORE

Having first been duly sworn by the Chairman, testified as follows:

DIRECT EXAMINATION

BY MR. STEWART:

Q. Would you state your name and address, please? A. My name is Claude H. Mullendore, P.O. Box 1396, Houston, Texas 77001.

Q. What is your occupation and by whom are you employed? A. I'm Senior Vice-President of Gas Supply and RegulatoryAffairs for Transcontinental Gas Pipe Line Corporation.

Q. How long have you been employed in that capacity? A. As Senior Vice-President of Gas Supply, four years, and regulatory affairs responsibilities for approximately eight months.

Q. Would you briefly describe the duties and responsibilities that you have as Senior Vice-President of Gas Supply and Regulatory Affairs? A. Primary responsibility for the acquisition of long term reserves for Transcontinental Gas Pipe Line Corporation falls among my duties. That is limited to the lower 48 states. [389] Regulatory Affairs are relations and coordination of certificate of rate matters with the Federal Energy Regulatory Commission, and also, in Gas Supply are the duties relating to contract administration of all gas purchase contracts, along with producer rate matters involving our purchase gas adjustment filings with the FERC.

Q. Would you give the Board a brief description of your education and experience in the oil and gas industry prior

to assuming your present position with Transcontinental? A. I graduated from the University of Oklahoma with a B.A. in Government and Economics and an L.L.B. After serving in the United States Air Force as an Assistant Judge Advocate, I joined the firm and had a brief stint of duty as Assistant County Attorney in Oklahoma City, Oklahoma. I joined the firm of Kerr, Conn and Davis in Oklahoma City where I was employed as an associate with that firm for approximately five years. During that time my legal responsibilities with the firm had to do primarily with the oil and gas industry, representing, among other producer clients, Kerr-McGee Corporation. My duties involved preparation of all instruments involved in oil and gas, including gas purchase contracts for and on behalf of producer clients, plus all filings and practice by those producer clients for the then Federal Power Commission.

Subsequent to that time I became staff attorney for Cities Service Gas Company in Oklahoma City, primarily assigned to litigation duties for and on behalf of that company, and [390] with particular emphasis with certificate and regulatory matters before the, what was then called the FPC.

Subsequent to that time I was corporate counsel for Northwest Pipe Line, and had all the responsibilities for the running of the legal department of that corporation, with particular emphasis on the divestiture by El Paso Natural Gas Company of the properties which were then being assigned to Northwest Pipe Line Corporation under a mandate from the United States Supreme Court relating to an anti-trust violation by El Paso.

After approximately two years in those duties I became an assistant Vice-President with Transcontinental Gas Pipe Line Corporation and then was made Vice-President of Marketing for that company, with particular emphasis on marketing natural gas and policy witness before the Commission—before the then FPC, relating to certificate

matters and marketing matters for Transco. I was then made Vice-President of Marketing and Rates for Transco and assumed the duty of all rate filings and rate matters for and on behalf of Transco before the FPC. I was then made Senior Vice-President of Marketing and Rates, and then I assumed my present duties approximately four years ago.

Q. Mr. Mullendore, how long have you been actively involved in negotiation or the execution of gas purchase contracts with interstate pipeline companies either on behalf of producers or on behalf of the pipeline company? A. The first gas purchase contract that I ever saw [391] was in 1956, and for five years thereafter I handled all gas purchase contracts, either negotiation or preparation of those contracts for and on behalf of producer clients for the firm that I was associated with. After that period of time with Cities Service Gas Company, I was also in charge of giving legal advice to the management for gas acquisition activities. Cities Service was and is an interstate pipeline under the Natural Gas Act. After that, with Northwest Pipe Line, I was in charge of all the gas purchase acquisition activities during the period that I was there.

During the last four years I have been activiely involved, again, in the preparation and negotiation of gas purchase contracts for and on behalf of Transco.

Q. Are you familiar with the customs and practices of interestate gas pipeline companies with respect to the purchase of gas for transportation and resale in interstate commerce? A. I am.

Q. Are you familiar with the current statutes, rules, and regulations of the Federal Government, and particularly, the Federal Energy Regulatory Commission with respect to the purchase of gas for transportation and resale into interstate commerce by interstate pipeline companies? A. I am.

BY MR. STEWART:

Mr. Chairman, I am going to tender Mr. Mullendore as an [392] expert witness in the field of the purchase of gas for transportation and resale into interstate commerce.

BY CHAIRMAN FANCHER:

You haven't said a word about Rule 48, Mr. Stewart. I'm not sure I want to qualify this witness as an expert, but he probably is.

BY MR. FRANKS:

Mr. Chairman, we think the qualifications are irrelevant and immaterial to the matters before the Board today and if he is going to testify in that field, we will object and I don't think the witness should be allowed to be qualified in an area that does not involve whether or not Rule 48 and and the matters relating to Rule 48 are being observed by Transco or not.

BY CHAIRMAN FANCHER:

Well, I don't want to be discourteous to the witness, but I think that the purpose of your attempting to qualify him as an expert, Mr. Stewart, is entirely irrelevant to this hearing.

BY MR. STEWART:

Mr. Chairman, if I might state, the purposes of this hearing is directly concerned with the purchase of gas, and as we will show, it is concerned with the purchase of gas by an interstate pipeline company.

BY CHAIRMAN FANCHER:

Mr. Stewart, I don't care if it's interstate or intrastate. Are you in violation of Rule 48, or are you not? It's [393] just as simple as that to me. But anyway, let the record show that the qulaifications of the witness are accepted for the purposes that Mr. Stewart has identified,

but I don't think we are going to let him testify along those lines. I don't see where his expertise in negotiations or pipeline contracts and the purchase of gas and that sort of thing is material to the hearing. Obviously, he has had broad experience in that field.

BY MR. FRANKS:

Mr. Chairman, he hasn't testified that he is familiar with the rules and regulations of this Board either.

BY CHAIRMAN FANCHER:

I understand that.

BY MR. FRANKS:

I think he is not qualified to testify as an expert witness unless he is familiar with the rules and regulations of this Board.

BY CHAIRMAN FANCHER:

He is an expert on the Federal rules and procedures and so forth, Mr. Franks, and that's what he asked that he be qualified as an expert, and I think he is. I would have to agree with that. But I think the Board wants to hear some testimony about Rule 48.

BY MR. STEWART:

Mr. Chairman, of course, we have submitted briefs on this particular point, but we certainly do feel that it is [394] very revelant as to whether or not it's an interstate pipeline company or an intrastate pipeline company, and we certainly feel that the extent to which the interstate pipeline company is governed by rules and regulations with other bodies is also entirely relevant. And to the extent to which they conflict with this Board's authorities or rules is also entirely relevant in the proceedings here to determine whether or not Transco should be adjudged in violation of Rule 48.

BY MR. FRANKS:

Mr. Chairman, I think what Mr. Stewart wants to prove is what the law is, and I think the briefs have set forth what the law may or may not be, and what he wants to say—is to have this witness to testify as an expert witness what the law is.

BY CHAIRMAN FANCHER:

We are not going to let him do that.

BY MR. FRANKS:

I think the Board has competent counsel to determine what the law is, and this witness shouldn't be allowed to testify as to what the rules and regulations and law of the Federal Energy Regulatory Commission is and what the Federal decisions are and things of that nature. If he is going to testify about that, that's already been covered in briefs and I think it's a waste of the Board's time to get into that, and especially, us lawyers try to tell the Board what we think the law is and we don't swear ourselves in as experts in the field to do it.

[395] BY MR. STEWART:

Mr. Chairman, the purpose of my questions of this witness are not to let him state his opinion as to the law; the purpose is to present facts to the Board which we believe will demonstrate to the Board that Transcontinental is under jurisdiction and is under particular orders and other facts which play an important part in this determination as to how much gas it can take, what prices it can pay for that gas. And to the extent that the plaintiffs contend that price is an element of discrimination, we, in order to present our case, must be allowed to explain to the Board why it is offering to pay the amount it is offering to pay and why it is not offering to pay the amount that the petitioners apparently want this Board to force them to pay.

BY CHAIRMAN FANCHER:

Mr. Stewart, could we say you are talking about market demand? You have an over-supply——

BY MR. STEWART:

That will be one of the elements we will discuss, Mr. Chairman. The other important element involved is the price at which the petitioners are requesting this Board to order Transco to pay——

BY CHAIRMAN FANCHER:

We are not going to order Transco to pay anything. That is not within our jurisdiction.

[396] BY MR. FRANKS:

Mr. Chairman, we will stipulate that Transco is a pipeline company subject to the jurisdiction of the Federal Energy Regulatory Commission.

BY CHAIRMAN FANCHER:

That's very obvious, yes, sir. I don't see anything in Rule 48 which makes any distinction between interstate or intrastate or any other kind or purchasers.

BY MR. STEWART:

Yes, sir——

BY CHAIRMAN FANCHER:

No, it says every purchaser, Mr. Stewart. You read the rule. It's just four lines.

BY MR. STEWART:

Yes, sir, I'm quite aware of what the rule says, but the fact is, Your Honor, this rule has been, to the best of our knowledge interpreted only once some 20 years ago. And the Board's interpretation of its own rules as to who it may or may not apply to, is certainly at issue in this hear-

ing at this time, and to the extent which we do not know that issue has ever been raised before this Board before.

BY CHAIRMAN FANCHER:

No, sir.

BY MR. TAYLOR:

Mr. Chairman, the petitioner, Coastal, would ask the [397] Board to inquire of counsel whether they are offering an excuse for violating Rule 48 and are admitting that they are violating it. The thrust of the statement is that they propose to show the Board why they feel it's necessary to violate the rule. The thrust of it is that apparently they are violating the rule.

BY MR. STEWART:

I'm not even going to respond to that, Mr. Chairman.

BY CHAIRMAN FANCHER:

All right, Mr. Stewart. Go ahead and we will see how far we will let you go, okay?
(Examination continuing by Mr. Stewart)

Q. Mr. Mullendore, is Transcontinental Gas Pipe Line Corporation an interstate pipeline company? A. It is.

Q. What distinguishes an interstate pipeline company from what is known as an intrastate pipeline company? A. Well, one of the most important aspects is the jurisdiction under which each of the different type of pipeline companies are regulated. Interstate pipeline companies, obviously, are regulated currently by the Federal Energy Regulatory Commission. Intrastate pipeline who buy for resale solely within the state in which the gas is purchased, may or may not have certain of their rates regulated by the Public Utility Commission, whatever the appropriate governmental authority might be called. Our rates, that is, interstate pipeline company rates, rate schedule, resale rates, authority to construct [398] facilities, what is proper

to be put into our rates, are all subject to the FERC jurisdiction.

Q. Is Transcontinental Gas Pipe Line taking——

BY MR. FRANKS:

Mr. Chairman, as I understand it, the witness is going to get into the profitability of Transco in the interstate pipeline business—as I understand it—because his rates are subject to it. The question as to whether it's profitable or not—I can't understand—we have already stipulated that they are an interstate pipeline company subject to the jurisdiction of the FERC.

BY CHAIRMAN FANCHER:

Are you objecting, Mr. Franks?

BY MR. FRANKS:

I think we are wasting time.

BY CHAIRMAN FANCHER:

Well, as I said yesterday, this thing is probably not going to be decided by this Board, but anyway, Mr. Stewart, he has admitted that you are an interstate pipeline company, and it's subject to the jurisdiction of the Federal Energy Regulatory Commission or agency, or whatever it is. I can't see the materiality of it.

BY MR. STEWART:

Mr. Chairman, again, we have indicated we are going to put on proof that this gas immediately upon—it's purchased by Transcontinental into the interstate system and to that extent [399] it is under the jurisdiction of the Federal Power Commission.

BY MR. FRANKS:

We will stipulate to that, Mr. Chairman.

BY MR. STEWART:

That's fine. I won't proceed any further with that testimony.

BY CHAIRMAN FANCHER:

Are you saying that we don't have jurisdiction of this matter?

BY MR. FRANKS:

Well, it's not under the—in that it goes into Interstate Commerce, we are not going to say that this gas is subject to the jurisdiction of the FERC.

BY CHAIRMAN FANCHER:

It's produced in Mississippi, isn't it?

BY MR. FRANKS:

Yes, sir, but it goes into Interstate Commerce. We are not going to stipulate any further than that.

BY MR. STEWART:

Mr. Chairman, my brief in this matter on these jurisdictional issues. I'll be glad to restate it for the Board, but it is our opinion and it's our position that the Board's jurisdiction over this matter does not include jurisdiction over the purchase of gas by an interstate pipeline company.

BY MR. TERRELL:

And Mr. Chairman, I refuse to stipulate to that.

[400] BY MR. FRANKS:

I do too.

BY CHAIRMAN FANCHER:

Mr. Stewart, let me be real candid with you. At first I had some very serious reservations about the authority of this Board to adopt Rule 48 in the first place. I have

had briefs from you—yours was about that thick. I had a brief from Mr. Terrell, I had a brief from Mr. Franks, Mr. Taylor, a brief from Mr. Waller, I had a brief from Mr. Watters. I read them every damn one, and I'm being paid about fifty cents an hour sitting up here doing this job. But I have convinced myself that Rule 48 is valid, and that the Board has the authority to adopt it. I don't know how we are supposed to enforce it, except to determine whether or not it is being violated. And I think that is our only authority. I can't help it if it's interstate or intrastate or municipally owned, or whatever. Go ahead.

BY MR. STEWART:

That clarifies your position, Mr. Chairman. (laughter)

BY MR. TAYLOR:

Mr. Chairman, for the purposes of the record the petitioner, Coastal, would ask are we on an offer or proof, or are we on the record?

BY CHAIRMAN FANCHER:

No, sir, we are on the record.

[401] BY MR. STEWART:

Q. Mr. Mullendore, is it the custom and practice of an interstate gas pipeline company when it enters into a gas purchase contract to agree to include gas sold to them under an Operating Agreement or other similar agreements between producers under minimum take obligations that may be included in that contract? A. Not in my opinion.

Q. Why not? A. First of all, all of the financing instruments under which pipelines finance their construction and all of the sales contracts under which they resell their gas provide and will require dedication of long term reserves under the contract.

BY MR. FRANKS:

Mr. Chairman, I move that the answer and the question—the answer to the question is irrelevant because it's been shown that in each and every instance in this case Transco did take the nonsignatory parties gas under the Operating Agreement. So, if his testimony is customary, these are not customary, none of them are customary. So, in this instance his answer is irrelevant because in each instance Transco has already purchased that gas under the Operating Agreement in every instance we have in the six wells involved.

BY MR. STEWART:

Mr. Chairman, the petitioner obviously thinks custom and practice is important because they put on proof on the [402] customs and practices of selling gas. We are clearly refuting that and putting on evidence in rebuttal of that. It's our position that gas purchase contracts are not made to include owners who do not sign that contract. That is not the custom and practice; that the contract at issue here, the contract between Getty and Transcontinental, is along that line, and the fact that Transco has taken gas from these wells not under that contract does not mean that they are obligated to take that gas under any contractual terms that may be in that field.

BY CHAIRMAN FANCHER:

Mr. Stewart, I think we went all over this yesterday. This Board is not here to interpret any contract. It's not here to make a contract or change a contract. We are here to dertermine whether or not Transco is now engaged in the business of purchasing oil or gas from owners, operators and producers, and that they shall purchase without discrimination in the favor of one operator, owner or producer against another in the same common source of supply We are not going to interpret the contract. I told you

yesterday you can go down to Pascagoula Street and get that done.

BY MR. STEWART:

Mr. Chairman, it's a question of interpretation of Rule 48. We take the position that discrimination does not mean under the same terms and conditions that some other interest owner in that field or in that well is selling gas.

[403] BY CHAIRMAN FANCHER:

Well, what does it mean?

BY MR. STEWART:

It means allow somebody equal access to a market; to a quantity. Now, if the Board is willing—if the Board would tell us what their interpretation is, then we won't get involved in the terms and conditions. But to the extent that the Board has to determine if there has been a violation, then they have got to interpret that rule.

BY MR. FRANKS:

Mr. Chairman, Coastal has had equal access to that market, the same market and they had equal access to it and they were complying with Rule 48 up until July 1. They are now in violation of Rule 48 because they have denied access to Coastal to that market, that equal market that he is referring to.

BY CHAIRMAN FANCHER:

Of course, they say they don't, Mr. Franks, that they make the market available to them but on different terms and conditions. Go ahead, Mr. Stewart.

BY MR. TAYLOR:

Mr. Chairman, Petitioner, Coastal object to counsel for Transco continuing to make his closing statements during the course of the examination of the witness and would request that they limit the questions and answers and to

be responsive to your rulings on objections and we can all be out of here early.

[404] BY MR. STEWART:

Mr. Chairman, I think Mr. Taylor is asking me not to respond to your questions.

BY CHAIRMAN FANCHER:

I think so too, Mr. Stewart. I'll have to agree with you for a change. Go ahead.

(Examination continuing by Mr. Stewart)

Q. Did you complete your answer to my previous question? I believe you were interrupted. Let me, if I could, restate the question. Is it the custom and practice of the interstate gas pipeline companies when entering into a gas purchase agreement to agree to include gas sold to them under Operating Agreements or any other agreements among producers under the minimum take obligations that may be included in that contract? A. I think I got as far as the financing instruments requiring dedicated reserves under contract for purposes of financing construction of pipelines. In addition, FPC and now the FERC requires certain dedicated contracts of reserves to back up requests for construction and certification of facilities necessary to transport and acquire such reserves. They do not take into account reserves purchased under an Operating Agreement with no contractual obligations. For purposes of testing debt coverages under debentures, independent engineers certificates must be obtained, and they do not take into account reserves so acquired under Operating Agreements. All of those [405] reasons, in addition to the resale contracts that we long term, resale contracts that we have necessary to supply gas to resale distributors and customers require long term reserve dedication. And those that are not under contract cannot qualify.

Q. Would such an obligation included in a gas purchase contract affect your ability to directly contract with other owners in the same pool or well? A. Well, obviously, it gives them the opportunity at some subsequent date to sign contracts with other pipeline companies, be they intra or inter, since there is no contractual obligation to take nor to deliver.

Q. Are you familiar with the terms and conditions of the gas purchase contract between Transco and Getty in the Newsom Field dated August 6, 1980, and which was ratified by Tomlinson with respect the Willoughby Well in those fields? A. Yes.

Q. Does this contract obligate Transco to purchase any gas owned by other parties——

BY CHAIRMAN FANCHER:

Mr. Stewart, I just don't want to hear anything about the terms of that contract now.

BY MR. FRANKS:

We object to it.

BY CHAIRMAN FANCHER:

Let's talk about ratable, nondiscriminatory take. I don't care what kind of contract they have got or what kind of [406] contract they don't have. That's not a matter for this Board to determine.

Q. (Mr. Stewart) Has Transco in the past taken gas from these wells that it was not contractually obligated to take? A. Yes.

Q. Would you explain why? A. There are essentially two reasons: one, the demand for natural gas in the market area—Transco's market area, was of sufficient quantity that these volumes could be taken. It did not—by so taking they did not cause a reduction in the reserves—long term reserves then currently dedicated to Transco. And, in fact,

assisted in the building up, somewhat, the reserve situation that Transcontinental had at that time.

Q. Has Transco instituted a policy in all of its purchasing markets of not purchasing gas at this time that it is not contractually obligated to take?

BY MR. FRANKS:

Mr. Chairman, we object to the question as being irrelevant and immaterial.

BY CHAIRMAN FANCHER:

I sustain the objection; policy has got nothing to do with it. Get back to Rule 48, Mr. Stewart, if you can find your way back to it. You know, I know and you know that they are going to buy the gas they can sell and they are not going to buy it if they can't sell it. That's what you are talking about.

[407] Q. (Mr. Stewart) Mr. Mullendore, can at this time Transco sell all of the gas that it is contractually obligated to take?

BY MR. FRANKS:

We object to that question as to not being relevant and material to the issues involved here.

BY CHAIRMAN FANCHER:

I sustain the objection. That, again, is a matter of contract. If they are obligated to buy it, they have got to buy it, whether they sell it or not.

Q. (Mr. Stewart) Mr. Mullendore, can Transco as of today sell gas on its distribution market that it is not contractually obligated to buy?

BY MR. FRANKS:

We object to the question as being irrelevant and immaterial to the issue involved here as to whether they are taking ratably from these six wells without discrimination.

BY CHAIRMAN FANCHER:

I wish I was somewhere else, Mr. Franks. I must sustain the objection. We are getting down to the matter of contract and we are talking about market demand, and I just can't see that that has anything to do with it, Mr. Stewart.

BY MR. STEWART:

Mr. Chairman, for four years now we have not had to worry about market demand.

[408] BY CHAIRMAN FANCHER:

I understand that.

BY MR. STEWART:

We are going to have to worry about it now and it does affect the ability of the pipelines to take gas from the state of Mississippi.

BY CHAIRMAN FANCHER:

I understand that.

BY MR. STEWART:

It has got contractual obligations that they have got to meet, and if they cannot sell the gas that they don't have contractual obligations to buy, then what are they supposed to do with the gas?

BY MR. FRANKS:

They are supposed to take into consideration when they buy the gas in Mississippi that it's subject to the rules and regulations of this Board, that's what they are supposed to take into consideration, Mr. Chairman. If they can't comply with them, they shouldn't buy the gas in this state.

BY CHAIRMAN FANCHER:

I'm not going to answer your question, Mr. Stewart, I don't think you would like it.

Q. (Mr. Stewart) Mr. Mullendore, does the present purchase of gas from East Morgantown and Greens Creek Fields impact your ability to sell the gas that you transport into Interstate Commerce——

[409] BY MR. FRANKS:

We object to the question as being irrelevant and immaterial to the issues involved here as to whether they are taking ratably and without discrimination from the parties in the six wells in question.

BY CHAIRMAN FANCHER:

I sustain the objection. Mr. Stewart, I think probably that all of these plaintiffs would stipulate with you that there is a glut of gas on the market today and that Transco has difficulty in disposing of the gas that they are obligated to purchase, much less additional gas, if that's what you are trying to prove, which I don't think has anything to do with the question.

BY MR. STEWART:

Mr. Chairman, I can probably ask a couple more questions if the Board will state that the price to which Transco is obligated to pay for this gas is not a matter of discrimination before this Board in determining a violation of Rule 48. Again, we have offered a market; the only difference in the terms and conditions is as to price, and that's the issue right here. We can close up shop and go home, if this Board will so rule.

BY CHAIRMAN FANCHER:

No, I don't think we are going to tell you that. That is a matter for the Board to determine.

BY MR. STEWART:

Mr. Chairman, I certainly think that Transco should be [410] allowed to put on evidence of the reasons why it has offered the price that it has. I would certainly think that

would be relevant to the Board, and it has to do with the ability to sell gas.

BY MR. FRANKS:

Mr. Chairman, we think it does not. We object to that. We think it does not under Rule 48, and we don't think this line of questioning is relevant to the issue.

BY CHAIRMAN FANCHER:

Go ahead, Mr. Stewart, we will let you make your record. On the record.

BY MR. STEWART:

Thank you.

BY MR. FRANKS:

Mr. Chairman, are you going to—I didn't understand.

BY CHAIRMAN FANCHER:

Mr. Franks, I don't really know what the outcome of this things is going to be down the road. I don't know whether the terms and conditions from $7.90 some-odd cents a MCF, which they have been paying for it, I understand, up until this date, and an offer to—well, with notification that they are not going to take it any longer unless they can take it at $5.00 with a market out provision, with a requirement that all of the small interest owners—nonsignatory interest owners select and designate an agent to represent them. I really don't know [411] whether that would be the criterion for enforcing Rule 48 or for adopting an order finding that they are in violation of Rule 48. Because, as I said, I don't think this Board is going to make the final decision. So, let's let him go ahead, if he will, but I think we already know all of that stuff.

BY MR. FRANKS:

Mr. Chairman, in order to expedite the matter, may I

have a continuing objection to all testimony of this witness until I notify the Chairman to the contrary?

BY CHAIRMAN FANCHER:

All right.

BY MR. STEWART:

Mr. Chairman, I think we would have saved a lot of time if the petitioner at the beginning of our presentation of our evidence had made that announcement.

BY CHAIRMAN FANCHER:

Okay, go ahead.

Q. (Mr. Stewart) Mr. Mullendore, did Transco institute a policy not to purchase gas that it was not contractually obligated to take or was not contractually dedicated to be delivered to them? A. Yes.

Q. Would you explain when this policy was instituted and why? A. It was instituted in approximately mid May, the [412] reasons why is that at that time we had approximately 420 million cubic feet of gas in fields that the reserves to which were dedicated to Transco cut back, and we found a further reduction in the market to the—as a result of which we had to reduce our cut backs to a total of approximately 520 million cubic feet a day. The market, as we stated in our market out letter, was softening as a result of the lower oil prices, particularly, with relation to number six fuel oil high sulphur content, which market is primarily for boiler fuel purposes and the impact of which we felt in our markets in North Carolina, South Carolina, parts of Virginia and Georgia. We had escalating costs in our gas purchase costs, and we needed to effectuate a program to reduce those costs, which resulted in market out letters being sent out and any and all surplus sales, that is, gas when we weren't contractually obligated to take to be cut off.

Q. Would you explain to the Board how the—what impact, if any, there is over the fact that the gas produced from these two fields is classified as high cost gas on your loss of market and your ability to continue to pay prices when you were not contractually obligated to do so? A. Our purchase gas costs are flowed directly through to the consumer as a result of purchase gas adjustments filings which we make with the Federal Energy Regulatory Commission. Currently, we make those filings twice a month—twice a year. [413] In mid March, as a result of conversations which the marketing department had with several of our distributors—customers, concerning the price of gas which became effective in March as a result of PGA, was having on their ability to continue to serve markets in direct competition with number six fuel oil of a high sulphur content type, and I'm talking about three percent. We evaluated what our gas purchase costs would be in September of this year as a result of escalating costs, both in the high cost area and in gas which is currently classified by the Commission in the 102, 3, 4, 5 categories. The Natural Gas Policy Act provides for an automatic escalation on a monthly basis for those classifications, without regard to what is happening in the market. As a result of those conversations and correspondence with our distributor customers and surveys that our marketing department took, it was determined that he had lost at that time to number six fuel oil high sulphur. And in some instances medium sulphur in the two percent range, approximately 95 to 100 million cubic feet of gas per day. The high sulphur, or the number six low sulphur, the market had not yet been impacted because that, obviously, costs most than the high sulphur content. We determined that in September when we filed our next PGA that we might experience increases as much as 65 to 70 cents increase in just our gas costs. In addition, we had a general rate increase then pending before the Federal Energy Regulatory Commission for which we had asked for an additional 35 cents.

That figure escapes me, [414] but I think it's about that, an increase due to increased facilities going into service and increased costs of doing business. So that we could see in addition to the market that we lost as a result of the March 1982 PGA that further the market loss would be experienced in September and October.

Q. What percentage—you indicated a loss of Transco's market of approximately 95 million cubic feet a day; what percent of your total resale market does that account for? A. That is in the range of about—and I'm talking about just related to that market, of about four percent, five percent, of our then daily flowing supply that we were sending to the market. On a system like ours, gas taken in the field either goes to the market and is burned, or it goes in storage. We had, thank goodness, a slightly colder than normal first quarter, so that our sales up until that time had stayed up, because it was primarily heating load. But going into the summer where boiler fuel sales become important along the system and industrial sales, and particularly, with the sales in September and October, we assumed that we would have, and assumed on the basis of discussions with the customers, that we would have a further market loss than what we had hoped for this year. We exercised the market out which reduced our prices somewhere to around 15 to 20 cents in the September PGA.

Q. When you say you exercised the market out, would you explain that a little, please? [415] A. Well, we sent out letters to producers whose contracts contained a market out and reduced the price that we were then currently paying to $5.00 per MMBTU, including taxes and all other costs. At that time about 10 percent of our flowing supply had been designated high cost gas. In looking at the gas cost, that 10 percent made up about 26 percent or 28 percent of our total gas costs. So, that was the situation in mid May.

Q. What was the purpose of attempting to reduce the price that you were paying for high cost gas? A. Obviously, it was an attempt to continue sales that we had hoped we would make in direct competition with number six fuel oil high sulphur and to keep the demand for gas up on our system so that we would not experience a further loss of market and worsen the situation of having to cut back further on the fields where we were taking gas under contract.

BY MR. FRANKS:

Mr. Chairman, of course that statement of what they are taking and not taking ignores the Rule 48 that we have.

BY CHAIRMAN FANCHER:

I understand that.

BY MR. FRANKS:

Without regard to Rule 48.

BY CHAIRMAN FANCHER:

It's all very interesting, Mr. Stewart, but I don't think you have told anybody anything we didn't already know. [416] They probably made some bad contracts, if you want to know the truth about it.

BY MR. STEWART:

I'm trying to prevent making any more, Mr. Chairman.

BY CHAIRMAN FANCHER:

I understand.

Q. (Mr. Stewart) Mr. Mullendore, does Transco at this time have a higher daily supply of gas than it can sell on its resales market? A. Yes.

Q. What is being done with this gas? A. It's being cut back in the fields.

Q. Are you cutting back your daily supply to exactly what you are able to sell on the resales market? A. That's correct.

Q. Are you storing any of this gas? A. Transco does not store gas for itself except with, I think, some 11 billion cubic feet of storage space, which is dedicated for entire system use. The other 160 billion cubic feet—170 billion cubic feet of storage is operated by Transco as a sort of warehouse. Customers buy the gas on a daily basis and nominate it either into storage or nominate it to the market to be burned. We operate a little bit different pipeline system with respect to storage than other pipelines do.

Q. Has Transco curtailed its gas takes to just high cost gas fields, such as, Greens Creek and East Morgantown Fields? [417] A. No.

Q. Is Transco currently not taking gas that it is contractually obligated to take? A. Yes.

Q. Approximately how much? A. The volumes that we can cut on the system currently without incurring take or pay obligations, is in the neighborhood of 200 million cubic feet of gas a day. Any gas that we cut below that, and do not make up on an annual basis, you incur take o pay on. So, currently, we have about 320 million of gas that we are incurring potential take or pay on.

Q. When you say "incurring take or pay" do you mean that you are obligated to pay for that gas even though you cannot take it? A. Yes, if the situation continues, we have incurrred currently about 70 million dollars of take or pay. We anticipate, because of the expiration of annual contract years or periods, that we will incur probably another 30 to 50 million dollars or take or pay by October 1 of this year.

Q. How does that impact your resale or your distribu-

tion market? A. Well, it drives the price up because we have to finance——

BY MR. FRANKS:

Mr. Chairman, as I understand it, we are now letting him make a record on all of this? Of course, I have a continuing [418] objection on all of this, but I just think we are unnecessarily prolonging this hearing with all of this testimony.

BY CHAIRMAN FANCHER:

I think so, too, Mr. Franks. I don't really want to cut you off, Mr. Stewart. I would like for you to make all of the record that you would like to, but insofar as I'm concerned, the other Board members may have different ideas, but I don't think the trials and tribulations and the troubles of Transco has anything to do with any part of this hearing. Like I say, Rule 48 is what we are here to talk about. And whether they can sell it or can't sell it, Rule 48 doesn't say anything about that.

BY MR. STEWART:

Yes, sir, but I think the Board is determining whether or not there is a violation of Rule 48. Is the Board saying their problems in paying a higher price for gas is not a factor?

BY CHAIRMAN FANCHER:

I don't think it is. It looks to me like we are getting right down to the question of whether or not Rule 48 is a valid rule and how it is to be applied. I mean, I think the facts are clear already. The way Mr. Mullendore is talking, Transco is in trouble. It kind of sounds like they may be.

BY MR. FRANKS:

They are not.

BY CHAIRMAN FANCHER:

It kind of sounds like they may be.

[419] BY MR. STEWART:

They would not like to be in trouble.

BY CHAIRMAN FANCHER:

I understand that.

Q. (Mr. Stewart) Mr. Mullendore, none of, or very few of your contracts require that you take 100 percent of the deliverability of a well, is that correct? A. Not very many.

Q. If Transcontinental is required to continue to take 100 percent deliverability from wells in these fields, how will that affect Transcontinental?

BY MR. FRANKS:

We object to the question, Mr. Chairman. If he is trying to say that, you know, if we can take Getty's gas and not take these little guy's gas, like Coastal. if that will help us out, that's what we want to do. But, you know, if we take their gas, we might get in a little trouble, and that is immaterial and irrelevant. It means if we can go ahead and violate Rule 48, we will come out all right, but if we have to comply with Rule 48, we might be in a little trouble, and that is not the issue. The issue is whether they are violating it or not, not an excuse for violating it and how it affects the financial structure of Transco.

BY MR. STEWART:

Mr. Chairman, it's our position that Rule 48 is not being violated, because these people have been offered "a chance" to sell their [420] share of gas.

BY CHAIRMAN FANCHER:

All right. Well, why do you need to get into all this other stuff, Mr. Stewart?

BY MR. STEWART:

Because the Board—because the petitioners obviously disagree with the position and the Board has said they are going to make a determination on what discrimination is. We are simply trying to show the Board that Transco——

BY CHAIRMAN FANCHER:

You have said you have offered them a market; is that what you said?

BY MR. STEWART:

Yes, sir, we are offering them a market today.

BY CHAIRMAN FANCHER:

Okay. If he can't sell the gas he has already got, how is he going to sell the gas under that market, at any price?

BY MR. STEWART:

We will explain it.

BY CHAIRMAN FANCHER:

I think you are getting way outside the scope of the hearing, Mr. Stewart.

BY MR. FRANKS:

Mr. Chairman, here is a public newspaper regarding how they are handling this cheaper gas right there from the Oil Daily.

[421] BY MR. STEWART:

Mr. Chairman, I believe I'm putting my case on, and I was very patient with Mr. Franks and Mr. Taylor when they put their case on, and I would appreciate an accomodation of sorts for me.

BY CHAIRMAN FANCHER:

I'm not going to read the paper. Mr. Waller?

BY MR. WALLER:

I think the Board is inclined to let the record cover whatever Mr. Stewart and Transco might want to leave in the record. If we could go with a proffer here and let Mr. Mullendore read his statement into the record, I think we could get through with this in a few minutes, because he is an attorney and I think he knows what he wants the record to reflect about Transco's plight in marketing and balancing out agreements and marketing out agreements.

BY CHAIRMAN FANCHER:

Could you do that, Mr. Stewart?

BY MR. STEWART:

Mr. Mullendore is not on the stand as an attorney; he is on the stand as a witness, and he is not prepared to issue a statement. If the Board had said they would like a statement, we could have saved a lot of time preparing testimony.

BY CHAIRMAN FANCHER:

All right, sir, go ahead, I want you to make your record.

BY MR. FRANKS:

We have a continuing objection.

[422] BY CHAIRMAN FANCHER:

Yes, sir.

Q. (Mr. Stewart) Mr. Mullendore, my last question I asked was: if Transco is required to take maximum deliverability from these wells, how will it impact Transco?

BY CHAIRMAN FANCHER:

I don't think we are going to require them to take any gas at maximum deliverability. And how it would impact

Transco, I think is entirely immaterial, even if we did do that—if we could do that.

BY MR. STEWART:

Do I understand, Mr. Chairman, that you are saying you don't know whether you can require them to take at maximum deliverability?

BY CHAIRMAN FANCHER:

I think we can require them to take it ratably and nondiscriminatorily, Mr. Stewart. How it would impact them or how it would affect them, I don't think is material.

• • • • • • • • • •

[424] Q. How does the price that you are currently offering these producers in return for the dedication of their gas to Transco compare with the prices that Transco is currently offering for any new contract on high cost gas in Mississippi or in any other state? A. We are not currently offering any new contract for high price gas at $5.00. So, to that extent it would be in tune with what we are paying our affiliate and also the people that we have exercised the market outs on.

Q. In your opinion is the present market price for high cost gas any higher than what Transco has offered to producers in these three wells? A. It is no higher.

Q. If Transco was required to purchase this gas at a price which is higher than they are contractually obligated or willing to pay, what impact would this have on Transco's interstate business? A. It would increase our gas costs, in addition to the gas costs that I have already discussed, and it would require us to cut back on other contracts on a one for one ratio.

Q. When you say "other contracts" other purchase contracts? A. Other purchase contracts, yes.

Q. Would these purchase contracts be in Mississippi or [425] in other states? A. It could be anywhere.

Q. To your knowledge is Transco the only pipeline facing the loss of market due to the increase in quantities and cost of high cost gas? A. To my knowledge it is not the only one.

Q. Even though this gas has now been classified as high cost gas under the Natural Gas Policy Act, is Transco's purchase and transportation and resale of this gas still regulated by the FERC? A. It is.

Q. Would you explain how it is continued to be regulated? A. The purchase gas costs that an interstate pipeline company pays for gas is passed along, as I have stated, in the semi-annual PGA. That's all subject to review by the FERC, not only with respect to the reasonableness of the prices under Section 601-C of the NGPA, but also with respect to whether the pipeline company is contractually obligated to pay any price, whatever the price may be, with respect to any of its contracts. Those PGA filings are subject to suspension by the FERC, and the FERC has investigative authority to determine the reasonableness of those costs.

Q. To what extent has the gas purchase contracts in East Morgantown and Greens Creek Field, as well as other high cost gas fields in the state of Mississippi, been subject to the [426] investigations by the FERC?

BY CHAIRMAN FANCHER:

What has that got to do with Rule 48, Mr. Stewart? You know, I'm just sitting here kind of—you know, what has the FERC got to do with this hearing?

BY MR. STEWART:

Mr. Chairman——

BY CHAIRMAN FANCHER:

I know they are subject to their regulations, and I know that when you are subject to the regulations of a federal agency, excuse me, John, you have got troubles.

BY MR. STEWART:

Mr. Chairman, we have got real troubles if we have got two orders from two different agencies that tell us to do two different things. That's the whole point of it.

BY CHAIRMAN FANCHER:

They haven't told you not to buy that gas, have they? Ratably, and without discrimination?

BY MR. STEWART:

I'm going to defer that to my expert.

BY CHAIRMAN FANCHER:

I don't believe they have done that.

BY MR. FRANKS:

The best evidence would be a copy of the order.

BY CHAIRMAN FANCHER:

Go ahead.

[427] Q. (Mr. Stewart) Mr. Mullendore, have you been required to file gas purchase contracts that are currently in effect in East Morgantown and Greens Creek Field with the FERC in connection with the NGPA dockets? A. We have filed pursuant to the administrative law judge's decision, all of our contracts. As a result of an investigation of our PGA filings commencing back with February 1981. That PGA filing was challenged on the basis that our gas purchase practices, particularly, with respect to purchase of high cost gas and prices paid for it, was in violation of Section 601-C of the NPGA. In nu-

merous allegations with respect to the contractual provision relating to take or pay and definite price escalations, the amounts paid for high cost gas, the volumes of high cost gas that were purchased, particularly with respect to the North Carolina Commission and the New York Public Service Commission, and concerning the impact of those purchases on markets of their distributor customers which they regulate. Two subsequent PGA filings were protested. We were required in the February 20 order of the FERC to file all contracts, who we were dealing with, who the other purchasers were in the field, what the other terms and provisions were; everything required in Appendix B to that FERC order with respect to all gas contracts.

Q. What investigation was made and what affect did it have in the investigation with respect to gas that Transco was not contractually obligated to take and was not dedicated [428] to Transco, but for which Transco was paying high cost gas prices? A. Inquiry was made, my recollection, as to whether Transco had exercised market outs, what they had done to keep the prices down, whether we were purchasing—whether we had exercised contract minimums under the contract, whether we had evaluated whether the producers were delivering just the gas that was under contract, etcetera. I was asked over a period of two days on the witness stand concerning all questions about as many of the high cost contracts as I would like to remember.

BY MR. STEWART:

Mr. Chairman, in connection with his testimony I would like to offer into evidence a copy of the orders of the FERC relating to the suspension of filing.

BY CHAIRMAN FANCHER:

I'm not going to allow that.

BY MR. FRANKS:

We object to that.

BY MR. STEWART:

May I proffer it for the record?

BY CHAIRMAN FANCHER:

You may make it for identification for purposes of the record, but I don't care what FERC said about this. You may mark it for identification.

(SAID DOCUMENT WAS MARKED AS EXHIBIT 1 TO THE TESTIMONY OF MR. MULLENDORE, FOR THE PURPOSES OF THE RECORD ONLY, AND APPEARS AS FOLLOWS:)

Exhibit 1

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. TA81-1-29-002

TRANSCONTINENTAL GAS
PIPELINE CORPORATION

NOTICE OF INTERVENTIONS, PROTEST AND MOTION FOR SUSPENSION AND HEARING OF THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK AND THE NORTH CAROLINA UTILITIES COMMISSION.

The Public Service Commission of the State of New York (New York) and the North Carolina Utilities Commission (North Carolina) herewith give notice, pursuant to the provisions of Section 1.8(a) of the Commission's Rules of Practice and Procedure, of their intervention as parties in the above designated proceeding. For the reasons detailed below, New York and North Carolina are convinced that the Commission cannot find that the increased rates which would be made effective by the instant PGA filing by Transcontinental Gas Pipeline Corporation (Transco) are just and reasonable within the meaning of Sections 4 and 5 of the Natural Gas Act and Section 601(b) of the Natural Gas Policy Act (NGPA), or appropriate for pass through under Section 601(c) of the NGPA. In addition, New York and North Carolina are convinced that the controllable price escalations indicated in the instant PGA filing by Transco are so high, both absolutely and in relation to the price of various categories of oil serving as a major alternate fuel in the markets served by Transco, as to mandate a thorough investigation of Transco's gas purchase operations pursuant to Section 14 of the Natural Gas Act.

2. Correspondence and pleadings relating to the intervention and participation in the proceeding by New York should be addressed to:

Peter H. Schiff
General Counsel
Empire State Plaza
Albany, New York 12223

Richard A. Solomon
Dennis Lane
Wilner & Scheiner
1200 New Hampshire Avenue, N.W.
Suite 300
Washington, D.C. 20036

3. Correspondence and pleadings relating to the intervention and participation in the proceeding by North Carolina should be addressed to:

R.J. Nery
Director, Natural Gas Division,
Public Staff
North Carolina Utilities Commission
P. O. Box 991
Raleigh, North Carolina 27602

Morton L. Simons
Simons & Simons
1629 K Street, N.W.
Washington, D.C. 20006

4. The instant filing involves a PGA tracking filing proposed to be effective on March 1, 1981, which according to Transco involves a net increase of 66.6 cents per dekatherm (dt) in the commodity or delivery charge of Transco's CD, G, OG, E, PS and S-2 rates, of 66.3 cents per dt in the commodity charge of the ACQ rate schedule, and 1.2 cents per dt in the delivery charge of its X-20 rate schedule.

Of the 66.6 cents increase, 65.4 cents is the result of producer price increases, with 62.3 cents representing an increase in the current purchased gas costs since the previous filing became effective on September 1, 1980 and 3.1 cents per dt reflecting an increase in the Deferred Adjustment. While the absolute level of this increase (which compares with the latest semi-annual increases for Tennessee Gas Pipeline and Texas Eastern Transmission Corp., two pipelines serving a number of the same customers as Transco, of 22.85 cents per Mcf and 17.25 cents per Mcf) would alone be sufficient in protestants' view to justify a hearing, our problems go well beyond this circumstance.

5. Thus the adjusted base cost of gas on the Transco system has risen in the last two-and-one half years from 82.5 cents per dt as of September 1, 1978, to $2.697 per dt as of March 1, 1981, an increase of $1.872 or 227%. This contrasts with an increase in gas costs during the same period for Tennessee of $1.09 or 119% and for Texas Eastern of 89 cents or 103%. Even more important, the latest increase brings the 100% load factor price for contract demand service and the charge under the General Service rate from Transco to $3.7614 for Zone 1, $3.7764 for Zone 2 and $3.8294 for Zone 3. These prices are at a level which, when distribution costs are added into the picture,[1] bring the burner tip price of Transco gas to levels which are rapidly approaching a price at which customers with alternate fuel capacity will switch to oil.[2] Thus as of

---

[1] Present markups for the three downstate New York customers of Transco for residential sales are Brooklyn Union, $2.22-2.41; Consolidated Edison, $2.59; and LILCO, $2.17.

[2] The Transco rates proposed to be effective as of March 1, 1981, include increases in its rates filed in Docket No. RP80-117, which are in effect, subject to refund, pending the outcome of that proceeding and also reflect a stay of the cost allocation issue litigated in Docket No. RP76-136, approved by the Court in *Public Service*

September 10, 1981, the price for No. 2 oil in New York City was 99.82 cents per gallon, equivalent to $7.13 per dt, and for low sulphur No. 6 residual oil, 78.8 cents per gallon, equivalent to $5.36 per dt.[3] Similarly, the current prices for No. 6 high sulphur oil in North Carolina, where it is the principal alternate fuel, is approximately 80.55 cents per barrel at the Port of Wilmington, equating to a burner tip price of about $5.41 per dt. Moreover, even if the instant filing would not result in any substantial loss of sales to alternate fuels, it is apparent that the continued ability of Transco's customers to maintain sales to industrial and other end users with alternate fuel capacity will be seriously jeopardized if Transco's purchased gas costs, which have escalated at a steadily increasing level over the last six PGA filings from 21.5 cents for the period between September 1, 1978 and March 1, 1979 to over 59 cents in the most recent six-month period, continues to follow this pattern.

6. The problems raised by Transco's filing are by no means limited to the possibility of loss of sales where the end users have the ability to utilize alternate fuels. For the Transco filing indicates the possibility that unnecessarily high costs for gas are being imposed upon Transco's customers as a result of its gas purchasing practices over

---

Commission v. *FERC*, Case No. 79-2182 (D.C. Cir.) It is thus probable that some or all of the rates will eventually be reduced from the levels indicated in Transco's filing in this docket. But gas consumers with alternate fuel capability will frequently shift to oil whenever the effective gas rate exceeds the cost of the oil they can utilize without regard to potential refunds should the gas rates subsequently be held to be invalid.

[3] These rates had risen substantially as of February 4, 1981, in reflection of the OPEC actions and the elimination of all of United States price controls on oil, coupled with weather related increases in demand.

which this Commission retains supervisory control. A substantial portion of the increases which have led to the more than tripling of Transco's purchased gas costs in the last two-and-one-half years is of course due to the statutory increases in the NGPA ceiling rates. But an increasing factor in the ever accelerating increases in Transco's PGA filings has been the impact of increased purchases of very high cost Section 107 gas.

7. Thus, in the last two Transco PGA filings the number of Section 107 sales has increased from 76 accounting for 4.87% of the volumes and 11.32% of the total purchased gas costs with an average price of $5.13 per dt, to 93 sale accounting for 10.81% of the volumes and 22.87% of the total purchased gas costs at an average cost of $5.88. Moreover, Transco in its latest filing, lists 59 contracts, responsible for one-sixth of all of its purchased gas costs (16.27%) with current prices of from $6-$7. These include two sales by Transco's production affiliate, Transco Exploration Company, at rates of $6.93 and $6.68, respectively, the latter of which involved six month volumes of almost 9 million Mcf. There are also included, for the first time, a number of purchases made in 1980 contracts at prices in excess of $7.00, including one purchase from the McCormick 1975 Oil and Gas Fund at a presently effective rate of $7.8114.

8. Recognizing the limitations on the Commission review of such purchases imposed by Section 601 of the NGPA, it is clear that Transco has not demonstrated that its gas purchase patterns, and particularly the Section 107 gas acquired at rates in the $5-$8 per dt range, meet the standards for automatic pass through established by Section 601(c)(2) of the Act. Moreover, with respect to the purchases by Transco from Transco Exploration (or from any other affiliated producer) there has been no showing by Transco that they meet the preliminary test of Section 601 (b)(1)(E) of the NGPA for determining whether they are eligible for pass through under 601(c)(2) in the ab-

sence of "fraud, abuse, or similar grounds". Thus, in the case of the sale by Transco Exploration to Transco from South Timbalier Block 148, the listed price of $6.93 is significantly higher than Transco is paying to unaffiliated producers for gas from the same block. Nor is there anything in the Transco filing from which the Commission can determine the extent to which there have been prepayments with respect to any of Transco purchases of a sort which might involve violation of any NGPA ceiling or to whether Transco's patterns of takes, as a result of unduly restrictive take-or-pay obligations or otherwise, have resulted in additional increases in the overall Transco gas costs.

9. We are convinced for the foregoing reasons that the Commission cannot find that the present filing meets the standards of either the Natural Gas Act or the NGPA, and the Commission accordingly must set the filing for hearing, suspend the effectiveness of the tariff for at least one day, and make any future collections of the increased rates subject to refund. However, the present filing clearly only reflects the tip of the cost increase iceburg Transco is obligated to reveal to collect increased rates commencing in March, 1981; no disclosure is made of the prices and estimated volumes of additional high cost gas Transco has already contracted for, or the probable effect thereof on its rates and the marketability of the gas when such sales become fully operative. Nor are New York and North Carolina aware of any Transco policy in contracting for new gas supplies which has the objective or effect of ensuring that the overall cost of its gas will be maintained at reasonable levels in relation to that of other pipelines or will remain marketable. Thus, it is our understanding that some pipelines, in purchasing high priced or deregulated gas, have insisted upon contract provisions which would permit renegotiation where the price for the sale escalates to a level which jeopardizes continued pipeline sales or is in excess of the delivered price of some specified grade of oil or

other alternate fuel in the pipeline's market area. Whether Transco has incorporated such protective clauses into its higher cost gas purchases has not been disclosed. Nor to the extent that an investigation may indicate that Transco has habitually agreed to more onerous take-or-pay provisions than its major pipeline competitors, has the necessity for such a practice been determined. Recognizing that Transco in the recent past has been in deeper curtailment than many of the other major pipelines, it does not follow that the necessary or appropriate solution to the problem is a contractual pattern which could lead to prices for Transco gas which, even on a rolled-in basis, will result in price-determined "curtailment" of service by its customers.

10. These circumstances convince New York and North Carolina that the Commission, in addition to setting the instant rate filing for hearing pursuant to Section 4 of the Natural Gas Act, should enter into an investigation of Transco's gas purchase practices and policies pursuant to its authority under Section 14 of the Natural Gas Act. Only through such an investigation can the Commission keep itself and the Congress informed as to long range issues regarding Transco's continuing viability as a pipeline able to provide gas to its customers at prices which will permit the gas to be marketed in the event alternate fuel prices fail to keep pace with Transco's indicated rate spiral. While some of the problems to which such an investigation would be directed are not unique to Transco, the abnormally large price increases it has reported in the last several years suggest that an investigation of its operations would be more productive than any such effort conducted on an industry-wide basis.

Accordingly, New York and North Carolina request that their intervention in this proceeding be noted and ask the Commission (1) to suspend Transco's PGA filing for one day, set it for hearing and require that any collection of

the increased rates pending Commission decision be made subject to refund with interest, and (2) enter into an investigation of Transco's gas purchase practices pursuant to Section 14 of the Natural Gas Act.

Respectfully submitted,

/s/ Richard A. Solomon
Richard A. Solomon
Wilner & Scheiner
1200 New Hampshire Avenue, N.W.
Suite 300
Washington, D.C. 20036

Attorney for the Public Service Commission of the State of New York.

/s/ Morton L. Simons
Morton L. Simons
Simons & Simons
1629 K Street, N.W.
Washington, D.C. 20006

Attorney for the North Carolina Utilities Commission.

February 18, 1981

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

PIPELINE RATES: SUSPENSION

Before Commissioners: Georgiana Sheldon, Acting Chairman; Matthew Holden, Jr., George R. Hall and J. David Hughes.

Docket No. TA81-1-29-002
(PGA81-1, IPR81-1,
DCA81-1 and LFUT81-1)

TRANSCONTINENTAL GAS
PIPELINE CORPORATION

ORDER ACCEPTING FOR FILING, SUBJECT TO CONDITIONS, AND SUSPENDING PROPOSED TARIFF SHEETS, AND ESTABLISHING PROCEDURES

(Issued February 28, 1981)

On January 29, 1981, Transcontinental Gas Pipeline Corporation (Transco) filed revised tariff sheets [1] to reflect a purchase gas adjustment (PGA) increase of approximately $273.6 million on a semi-annual basis. Such filing reflects (1) a 62.3 cents per dth increase in the commodity charge of Rate Schedules CO, G, OG, E, PS, S-2 and ACQ to track increases in the cost of purchased gas ($255,964,981); (2) an increase of 3.1 cents per dth in the deferred surcharge of Rate Schedules CO, G, OG, E, PS, S-2 and ACQ to recoup underrecoveries of $156,663,765. (3) a 0.3 cent

---

[1] Twentieth Revised Sheet No. 12, Twentieth Revised Sheet No. 15 and Third Revised Sheet No. 16 to FERC Gas Tariff, Second Revised Bolume No. 1 and Twenty Sixth Revised Sheet Sheet No. 121 to FERC Gas Tariff, Original Volume No. 2.

per dth increase for curtailment related credits in Rate Schedules CO, G, OG, E, PS, S-2 and Z-20 to recover $354,-474 in underrecoveries; and (4) an increase of 0.9 cent per dth in the Louisiana First Use Tax surcharge to recover an estimated balance of $40,059,191. Transco requests an effective date of March 1, 1981.

Public notice of the filing was issued on February 3, 1981, providing for protests or petitions to intervene to be filed on or before February 18, 1981. Petitions to intervene were filed by those petitioners listed in Appendix A. Having demonstrated an interest in this proceeding warranting their participation, they shall be granted intervention. In addition, a joint notice of intervention was filed by the Public Service Commission for the State of New York and the North Carolina Utilities Commission (the State Commissions).

The State Commissions in their joint notice of intervention protest Transco's filing and request that it be suspended and set for hearing. Specifically, they allege that the Commission cannot find that the increased rates which would be made effective by the instant PGA filing are just and reasonable within the meaning of Sections 4 and 5 of the Natural Gas Act and Section 601(b) of the Natural Gas Policy Act (NGPA), and, therefore, such rates are not appropriate for guaranteed recovery under Section 601(c)(2) of the NGPA. The State Commissions state that the increase in Transco's purchased gas costs have been much more rapid than that of comparable pipelines and that Transco's rates may soon price certain of Transco's distributor customers out of the industrial sales market.[2] They argue that certain purchases by Transco from its producer affiliate may not meet the "affiliated entities" test of Section 601(b)(1)(E) of the Natural Gas Policy Act (NGPA)

---

[2] This is because Transco's rates will soon surpass the price of alternative fuels in certain markets.

and further that prices paid for 107 gas from non-affiliated producers may not meet the requirements of Section 601(b) and 601(c)(2) of the NGPA.

In its deliberations on the State Commissions' request to set for hearing the question of whether Transco should be allowed to passthrough the cost of deregulated gas, the Commission remains uncertain as to the particularities of the State Commissions' allegations

Situations might exist where we could deny passthrough of gas costs in accord with Section 601(b) and (c).[3] We are not able at this stage to say whether the State Commissions' allegations sufficiently define a wrong which would lead the Commission to deny passthrough in accord with Section 601(c). The mere conclusory allegation of a violation without any factual or indicative elements supporting such an allegation would ordinarily not be sufficient to lead the Commission to set the matter for hearing. However, this being a case of first impression, we believe it essential that the legal and factual issues relating to Section 601(c) be resolved at hearing. We therefore in this instance will refer such matters to an Administrative Law Judge for initial consideration.

More specifically, the Commission does not perceive that Section 601(c) provides for an examination of prudence, as would be the case under conventional Natural Gas Act rate proceedings, based upon Transco's purchasing the subject gas, rather than other types of gas. However, when assertions are presented that Section 107 purchases involve conduct which rise to the level of fraud, abuse, or similar circumstances, we have a duty to evaluate them under the statutory criteria in Section 601(c). Abuse, in this context,

---

[3] The identity of, or differences between, "fraud", "abuse" or "similar grounds", when stated disjunctively in Section 601(c) is a particularly difficult but important question.

does not refer to imprudence but to serious improprieties. The State Commissions' allegations suggest improper behavior which may rise to that level, and that is the question we are setting for the judge's consideration. Allegations of fraud and similar behavior are serious matters and the Commission will pursue such matters to the appropriate extent. However, it is important to emphasize that Section 601 establishes a guarantee of cost passthrough for Section 107 gas absent a finding of fraud, abuse or similar grounds, and protestants have a heavy burden of proof to demonstrate the impropriety that would trigger the "fraud, abuse or similar grounds" basis for denying passthrough of costs.

Based upon a review of Transco's filing, the Commission finds that the proposed tariff sheets have not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory, or otherwise unlawful. Accordingly, the Commission shall accept Transco's filing and suspend its effectiveness so that it shall become effective March 1, 1981, subject to conditions described below, subject to refund, and subject to the proceedings dscribed below.

In a number of suspension orders,[4] the Commission has addressed the considerations underlying the Commission's policy regarding rate suspensions. For the reasons given there, we have concluded that rate filings should generally be suspended for the maximum period permitted by statute where preliminary study leads the Commission to believe that the filing may be unjust and unreasonable or that it may run afoul of the other statutory standards. It has been acknowledged, however, that shorter suspensions may be warranted in circumstances where suspension for the maximum period may lead to harsh and inequitable results.

---

[4] *E.g., Valley Gas Transmission, Inc.*, Docket No. RP80-98 (August 22, 1980) (one day suspension); *Great Lakes Gas Transmission Company*, Docket No. RP80-134 (September 24, 1980) (five month suspension).

Such circumstances have been presented here. A rate change filed pursuant to Commission authorized tracking authority is the type of circumstance which justifies a shortened suspension period. Accordingly, we believe we should exercise our discretion to suspend the rate, but permit the rate to take effect March 1, 1981, subject to refund, and subject to the condition set forth below.

Transco's PGA increase reflects purchases from a producer-affiliate, Transco Exploration Co., in the South Timberline Block 148, Offshore Louisiana, of deregulated high-cost NGPA Section 107 gas priced at $6.8098 per dth. The Commission is unable to determine from the information submitted by the pipeline whether the proposed purchase price assigned to its affiliated production satisfies the affiliated entities limitation set forth in Section 601(b)(1)(E) of the Natural Gas Policy Act (NGPA). That Section provides that in the case of any first sale between any interstate pipeline and any affiliate of such pipeline, any amount paid shall be deemed just and reasonable if in addition to not exceeding the applicable maximum lawful price ceiling, such amount does not exceed the amount paid in comparable first sale transactions between persons not affiliated with such pipeline. Accordingly, the Commission's acceptance of this increase is conditioned upon Transco's filing, within thirty days of issuance of this order, data responsive to the data request attached in Appendix B. In essence, the data request seeks information demonstrating that the price paid for such production meets the affiliated entities test. This shall also be an issue in the evidentiary proceeding hereinafter ordered.

In addition, Transco's general, system-wide rate increase is subject to proceedings in Docket No. RP80-117. In such proceeding, one issue raised is whether Transco's current accounting methodology concerning the gas cost associated with storage service results in an overcollection of purchased gas costs. Accordingly, the determination of that

issue in the present PGA filing shall be made subject to the outcome of that issue in Docket No. RP80-117.

Furthermore, the Commission notes that Transco's filing also includes increases pursuant to area rate clauses in its contracts with producers. The Commission's acceptance of this filing shall not constitute a determination that any or all of the area rate clauses permit NGPA prices. Should it ultimately be determined—in accordance with the procedures prescribed in Order No. 23, as amended by subsequent orders in Docket No. RM79-22—that a producer is not entitled to an NGPA price under an area rate clause, the refunds made by the producer to Transco shall be flowed through to the ratepayers in accordance with the procedures prescribed in Transco's PGA clause.

In addition, the Commission notes that Transco's deferred purchased gas cost account (Account No. 191) reflects $10.7 million in unpaid accruals. Transco indicated these unpaid accruals are attributable to purchases from producers who have NGPA well category determination filings pending for higher rates. Transco has included an estimated effect of the higher rates for these purchases. Such inclusion of unpaid accruals in the deferred account is inconsistent with the Commission's Regulations governing purchase gas costs. Accordingly, Transco is directed to remove unpaid accruals from its deferred Account No. 191 and to file within 30 days revised tariff sheets, to be effective March 1, 1981, eliminating such costs from the pipeline's deferred account.

The Commission Orders:

(A) Pursuant to the authority of Section 601 of the Natural Gas Policy Act and the Natural Gas Act, particularly sections 4, 5, 7, 8 and 15 thereof, and the Commission's Regulations, a public hearing shall be held concerning the lawfulness of the rates proposed by Transco in such PGA filing.

(B) A Presiding Administrative Law Judge to be designated by the Chief Administrative Law Judge for that purpose (18 C.F.R. 3.5(d)), shall convene a pre-hearing conference in this proceeding to be held within 30 days after the issuance of this order in a hearing room of the Federal Energy Regulatory Commission, 825 North Capitol Street, N.E., Washington, D.C. 20426. The Presiding Administrative Law Judge is authorized to establish such further procedural dates as may be necessary and to conduct further proceedings in accordance with this order and the Rules of Practice and Procedure.

(C) Subject to the conditions set forth in the body of this order and the ordering paragraphs below. Transco's proposed tariff sheets are accepted for filing and, suspended, subject to refund, to become effective March 1, 1981.

(D) The issue in this docket of whether such PGA filing contains any overcollections due to Transco's current storage pricing methodology is made subject to the outcome of that issue in Docket No. RP80-117.

(E) Transco is ordered to file on or before 30 days after the issuance of this order revised tariff sheets to become effective March 1, 1981, reflecting the removal of $10.7 million in unpaid accruals from Account No. 191.

(F) Transco shall file data as set forth in Appendix B within thirty days of the issuance of this order to show that the pricing of affiliate-owned production is in accordance with Section 601(b)(1)(E) of the NGPA.

(G) The costs associated with Transco's affiliate-owned production shall be collected subject to refund and subject to: (1) Transco's filing within thirty days of the issuance of this order the data called for in Paragraph (F) above, and (2) review of such data by the Commission to determine what further action is appropriate.

(H) The petitioners listed in Appendix A to this order are permitted to intervene in this proceeding subject to the rules and regulations of the Commission; *provided, however,* that the participation of the intervenors shall be limited to matters affecting asserted rights and interests specifically set forth in their petition to intervene and *provided, further,* that the admission of such intervenors shall not be construed as recognition that they might be aggrieved by any order entered in this proceeding. However, the Commission denies New York's and North Carolina's request for an investigatory hearing.

By the Commission.

(SEAL)

/s/ KENNETH F. PLUMB
Kenneth F. Plumb,
Secretary.

APPENDIX A

Transcontinental Gas Pipeline Corporation

Docket No. TA81-1-29-002

Petitioners for Intervention

Elizabethtown Gas Company

South Jersey Gas Company

Eastern Shore Natural Gas Company

Philadelphia Gas Works

Pennsylvania Gas and Water Company

Piedmont Natural Gas Company, Inc.

Frederick Gas Company, Inc.

APPENDIX B

In order to make a determination regarding whether or not Transco's affiliated purchases of Section 207 gas meets the affiliated entities test additional information is required. Please submit the following information:

(1) Please identify other sources of gas priced pursuant to Section 107 of the NGPA on Transco's system or purchased by Transco as of March 1, 1981. Further, please provide:

(a) contracts between Transco and the suppliers of such gas;

(b) the geographic origin of such supplies including file and A.P.I. well number;

(c) indicate if any of the Section 107 wells are jointly owned. If so, provide the names of the other sellers and, if applicable, other buyers;

(d) the price and purchase volumes of such gas;

(e) the pricing mechanism for such gas if no contract applies;

(f) indicate if the contract has in it, or has determined, a maximum ceiling price for such gas. Provide details.

(2) Please state whether Transco has negotiated or is negotiating for other supplies of gas priced pursuant to Section 107 of the NGPA. If so, please include the following information for the period as of March 1, 1980.

(a) indicate the seller of such gas;

(b) identify the geographic origin of such supplies including field and well number;

(c) state the price requested by the seller and the price offered by Transco. Include the volume of gas in-

volved and the time period of negotiations for each parcel of gas; and

(d) if such gas was not purchased explain why these supplies were not contracted for by Transco.

(3) Please identify any other producers of Section 107 gas who produce gas either from the same filed Transco purchases or produces its Section 107 gas or adjacent fields thereto and the prices paid for such purchases.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

PIPELINE RATES: SUSPENSION, CONSOLIDATION

Before Commissioners: C. M. Butler III, Chairman; Georgiana Sheldon, Matthew Holden, Jr., and J. David Hughes.

Docket Nos. TA81-2-29-001 (PGA81-2, IPR81-2, DCA81-2), TA81-1-29 (PGA81-1), RP80-117 and TA81-1-29-002

TRANSCONTINENTAL GAS PIPELINE CORPORATION

ORDER ACCEPTING FOR FILING AND SUSPENDING PROPOSED TARIFF SHEETS SUBJECT TO REFUND AND CONDITIONS AND CONSOLIDATING PROCEEDINGS

(Issued August 31, 1981

On July 31, 1981, Transcontinental Gas Pipeline Corporation (Transco) filed tariff sheets [1] reflecting a decrease of approximately $169 million to track a decrease of 38.5 cents per dth in the commodity charge of Rate Schedules CD, G, OG, E, PS and S-2, a decrease of 39.6 cents per dth under the ASQ schedule and an increase of 1.1 cents per dth in the delivery charge of Rate Schedule X-20. Transco requests an effective date of September 1, 1981.

This filing reflects the following adjustments: (1) an 8.9 cents per dth increase in the commodity charge of Rate Schedules CD, G, OG, E, PS, S-2 and ACQ to track in-

[1] Twenty-Second Revised Sheet Nos. 12 and 15 and Fourth Revised Sheet No. 16 to Second Revised Volume No. 1 and Twenty-Eighth Revised Sheet No. 121 to Original Volume No. 2.

creases in the cost of purchased gas ($39,139,292); (2) a decrease of 48.5 cents per dth (from 34.5 cents to negative 14.0 cents) in the deferred surcharge of Rate Schedules CD, G, OG, E, PS, S-2 and ACQ to return overrecoveries of $61,618,142 in the deferred account; and (3) an increase of 1.1 cents per dth for curtailment related credits in Rate Schedules CD, G, OG, E, PS, S-2 and X-20.

Public notice of the filing was issued on July 31, 1981, providing for protests or petitions to intervene to be filed on or before August 19, 1981. Petitions to intervene were filed by the Elizabethtown Gas Company, Atlanta Gas Light Company, Washington Gas Light Company and Frederick Gas Company, Inc., Process Gas Consumers Group, Public Service Electric and Gas Company, Piedmont Natural Gas Company, Inc., and Philadelphia Gas Works. Also notices of intervention were filed by the Public Service Commission of New York (New York) and the North Carolina Utilities Commission (North Carolina). Having demonstrated an interest warranting their participation, intervention is granted.

In addition to noticing its intervention, New York filed a protest and request for a hearing, North Carolina joined in New York's protest and also requested that the Commission consolidate any hearing with the ongoing investigation of Transco's previous PGA filing.[2] Specifically, New York requests a hearing on the issues of whether the prices paid by Transco for Section 107 deregulated gas to

---

[2] Transco's previously filed PGA rate increase in Docket No. TA81-1-29 (PG81-1), effective March 1, 1981, was accepted for filing and suspended by Commission order issued February 28, 1981, for further investigation into Transco's gas purchase practices and policies. Specifically, this proceeding is examining the issue of whether Transco's gas purchase prices are excessive due to "fraud, abuse or similar grounds" under Section 601(c)(2) of the NGPA.

nonaffiliated producers are excessive due to fraud, abuse or similar grounds and whether the prices paid to affiliated producers for Section 107 gas exceed the prices paid in comparable transactions by non-affiliated parties.[3] Since these issues are currently under investigation in Transco's prior PGA filing, and in view of the significant increases cited by New York of prices paid by Transco for Section 107 gas, the Commission concludes that Transco's pending PGA rate increase investigation is a more appropriate forum to address the potential issues raised in the instant filing. Consequently, the instant filing shall be consolidated with the proceedings in Docket No. TA81-1-29 for purposes of hearing and decision.

Also, New York alleges that while the instant filing involves a decrease of 39.6 cents per dt in the commodity charges, this decrease is the result of a gross underestimate by Transco of the amount of gas it would sell in the six month period March 1 through August 31, 1981, which has resulted in an overcollection of $61,618,142 or approximately 48.5 cents per Mcf. New York states that in such situations where the rates which become effective were almost 50 cents in excess of what they should have been, retail customers with alternative fuel capability will receive the wrong market signals as to the potential cost of gas and may switch to alternative fuels rather than depending on possible refunds from Transco.

The Commission finds that there is insufficient information contained in the filing as to show why Transco overestimated its PGA rates. Accordingly, the Commission will defer any action on this issue pending receipt from Transco of an answer to New York's petition setting out in detail its reasons for the resulting overestimate.

Based upon a review of Transco's filing, the Commission finds that the proposed tariff changes have not been shown

---

[3] *See:* Section 601(b)(1)(E) of the NGPA.

to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or otherwise unlawful. Accordingly, the Commission shall accept the revisions to the tariff sheet for filing and suspend their effectiveness, subject to refund and conditions, as indicated below.

In a number of suspensions orders,[4] the Commission has addressed the considerations underlying its policy regarding rate suspensions. For the reasons given there, we have concluded that rate filings should generally be suspended for the maximum period permitted by statute where preliminary study leads the Commission to believe that the filing may be unjust, unreasonable, or that it may run afoul of the other statutory standards. It has been acknowledged. however, that shorter suspensions may be warranted in circumstances where suspension for the maximum period may lead to harsh and inequitable results. Such circumstances have been presented here. Since this filing is not intended to increase revenues, the Commission shall suspend the effectiveness of the proposed tariff sheets such that they shall become effective on September 1, 1981, subject to refund and subject to modification in the consolidated proceedings established by this order.

Further, the Commission in its investigation of Transco's general rate increase in Docket No. RP80-117 found that Transco's current method of pricing of injections and withdrawals from storage service may result in a double recovery of a portion of the storage gas costs. Accordingly, the instant filing shall be suspended and made subject to refund pending the final disposition of the proceedings in Docket No. RP80-117.

---

[4] *E.g., Valley Gas Transmission, Inc.*, Docket No. RP80-98 (August 22, 1980) (one day suspension); *Great Lakes Gas Transmission Company*, Docket No. RP81-134 (September 24, 1980) (five month suspension).

Transco's instant filing fails to provide the carrying charge calculations on their deferred account balances (Account No. 191) shown in their deferred surcharge calculations. Accordingly, the Commission's acceptance of Transco's filing shall be conditioned on Transco supplying those calculations.

Transco's filing includes increases pursuant to area rate clauses in its contracts with producers. The Commission's acceptance of this filing shall not constitute a determination that any or all of the area rate clauses permit NGPA prices. Should it ultimately be determined in accordance with the procedures prescribed in Order No. 23, as amended by subsequent orders in Docket No. RM79-22,[5] that a producer is not entitled to an NGPA price under an area rate clause, the refunds made by the producer to Transco shall be flowed through to the ratepayers in accordance with the procedures prescribed in Transco's PGA clause.

The Commission orders:

(A) Subject to the conditions set forth in the body of this order and in the ordering paragraphs below, Transco's Twenty-Second Revised Sheet Nos. 12 and 15 and Fourth Revised Sheet No. 16 to Second Revised Volume No. 1 and Twenty-Eighth Revised Sheet No. 121 to Original Volume No. 2 are accepted for filing and suspended, and waiver of notice requirements is granted so that they may go into effect September 1, 1981, subject to refund.

(B) Pursuant to the authority of Section 601 of the Natural Gas Policy Act, the Natural Gas Act, particularly sections 4, 5, 7, 8 and 15 thereof, and the Commission's Regulations, a public hearing shall be held concerning the issue of the Section 107 purchased gas costs.

---

[5] These orders were recently affirmed in *Pennzoil Company v. Federal Energy Regulatory Commission*, —— F.2d ——, Nos. 79-1247, 79-1602 (5th Cir., May 20, 1981).

(C) Transco's revised tariff sheets are made subject to the final disposition of the storage pricing issue in the proceedings in Docket No. RP80-117.

(D) The hearing into the "fraud, abuse or similar grounds" question in this docket is consolidated with the pending investigation in Docket No. TA81-1-29 (PGA81-1).

(E) Transco shall within 15 days, file with the Commission Account No. 191 carrying charge calculations on the balances in Account No. 191 reflected in the rates in this filing.

(F) The petitioners identified in the body of this order are permitted to intervene in this proceeding subject to the rules and regulations of the Commission; provided, however, that the participation of the intervenors shall be limited to matters affecting asserted rights and interests specifically set forth in their petitions to intervene; and provided, further, that the admission of such intervenors shall not be construed as recognition that they might be aggrieved by any order entered in this proceeding.

By the Commission.

(SEAL)

/s/ KENNETH F. PLUMB
Kenneth F. Plumb,
Secretary.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

PIPELINE RATES : SUSPENSION; PGA

Before Commissioners: C. M. Butler III, Chairman; Georgiana Sheldon and J. David Hughes.

Docket No. TA82-1-20-000
(PGA82-1) (IPR82-1)
(DCA82-1)

TRANSCONTINENTAL GAS PIPE LINE CORPORATION

ORDER ACCEPTING FOR FILING AND SUSPENDING PROPOSED TARIFF SHEETS, SUBJECT TO REFUND AND TO CONDITIONS

(Issued February 26, 1982)

On January 29, 1982, Transcontinental Gas Pipe Line Corporation (Transco) filed a purchased gas cost adjustment (PGA) rate increase proposed to become effective March 1, 1982.[1] Transco's filing reflects an increase of approximately $92.6 million, and proposes the following adjustments: (1) a 27.20 cents per dth increase in the commodity charge of Rate Schedules CD, G, OG, E, PS, S-2, and ACQ; (2) a decrease of 4.30 cents per dth in the deferred surcharge of Rate Schedules CD, G, OG, E, PS, S-2, and ACQ to return overrecoveries of $81,364,003; and (3) an increase of 2.1 cents per dth for curtailment-related credits in Rate Schedules CD, G, OG, E, PS, S-2, and X-20.

---

[1] Third Revised Twenty-Second Revised Sheet Nos. 12 and 15, Fifth Revised Sheet No. 16 to FERC Gas Tariff, Second Revised Volume No. 1, and Second Revised Twenty-Eighth Revised Sheet No. 121 to FERC Gas Tariff, Original Volume No. 2.

Public notice of Transco's filing was issued on February 5, 1982, providing for comments, protests, or petitions to intervene to be filed by February 19, 1982. Timely petitions to intervene have been filed by the petitioners listed in Appendix A. Having demonstrated an interest in this proceeding warranting their participation, each of these petitioners shall be granted intervention. In addition, a Notice of Intervention, Protest and Complaint and Request for Suspension and Hearing was filed by the Public Service Commission of the State of New York (New York), and a Notice of Intervention was filed by the North Carolina Utilities Commission.

On February 22, 1982, an untimely petition to intervene was filed by the Piedmont Natural Gas Company, Inc. (Piedmont), setting forth no grounds for the late filing of the petition. For lack of good cause shown for the late filed petition, Piedmont's petition to intervene is denied pursuant to Section 1.8(d) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 1.18(d) (1981).

Based upon a review of Transco's filing, the Commission finds that the proposed tariff sheets have not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory or otherwise unlawful. Accordingly, the Commission shall accept Transco's filing and suspend the effectiveness so that it shall become effective on March 1, 1982, subject to refund and subject to the conditions described below.

In a number of suspension orders,[2] the Commission has addressed the considerations underlying the Commission's policy regarding rate suspensions. For the reasons given

---

[2] *E.g., Valley Gas Transmission, Inc.*, Docket No. RP80-98 (August 22, 1980) (one day suspension); *Great Lakes Gas Transmission Company*, Docket No. RP80-134 (September 24, 1980) (five month suspension).

there, we have concluded that rate filings should generally be suspended for the maximum period permitted by statute where preliminary study leads the Commission to believe that the filing may be unjust, unreasonable or that it may be inconsistent with other statutory standards. It has been acknowledged, however, that shorter suspensions may be warranted in cicumstances where suspension for the maximum period may lead to harsh and inequitable results. Such circumstances exist here. A rate change filed pursuant to Commission authorized tracking authority is the type of circumstance which justifies a shortened suspension period. Accordingly, we believe we should exercise our discretion to suspend the rate, but permit the rate to take effect March 1, 1982, subject to refund, and subject to the conditions set forth in the body of this order and in the ordering paragraphs below.

Transco's filing reflects in the deferred account balance costs associated with injections into and withdrawals from its storage facilities. The inclusion of these costs may result in a double recovery of a portion of the charge for storage gas because of Transco's method of pricing these injections and withdrawals. The Commission is unable to determine from the information given in the filing, however, whether such a double recovery does in fact occur. We are therefore suspending Transco's filing, making it effective March 1, 1982, subject to refund, and to Transco's filing additional information supporting the storage costs contained in the filing.

In its protest, New York states, among other things, that the present filing and two of Transco's earlier suspended PGA filings contain related issues. Specifically, New York states that Transco's present filing contains a number of purchases of gas deregulated under Section 107 of the Natural Gas Policy Act which are well in excess of market clearing prices. Further, New York observes that the Co-

mission has suspended and set for hearing Transco's earlier filings in Docket Nos. TA81-1-29 and TA81-2-29 to consider whether any of the costs associated with Transco's gas purchases should be denied pass-through because of fraud, abuse, or similar grounds under Section 601(c)(2) of the NGPA. New York requests the Commission to suspend the present filing, subject to refund, and to set it for hearing on the issue of the lawfulness of Transco's rates under Section 601(c)(2) of the NGPA, but states that it is not at this time requesting consolidation of this proceeding with the consolidated proceedings pending on this issue in Docket Nos. TA81-1-29 and TA81-2-29. Instead, New York suggests that the Commission should designate the Presiding Judge in Docket Nos. TA81-1-29 and TA81-2-29 to preside over the proceeding on the present filing, and authorize the Judge to determine how this proceeding should be coordinated with the proceedings in the two earlier dockets. Since some of the costs associated with Transco's gas purchases in the present filing are currently under investigation in Docket Nos. TA81-1-29 and TA81-2-29, we find that it is appropriate in this case to accept Transco's filing and to suspend it, placing it into effect subject to refund and subject to the final disposition of the proceedings in Docket Nos. TA81-1-29 and TA81-2-29.

Furthermore, Transco's filing does not contain sufficient information to determine whether separate subaccounts are maintained in Account No. 191, as required under Part 201 of the Commission's regulations concerning the Uniform System of Accounts, 18 C.F.R. § 201.191(D) (1981). Because of this lack of information, the Commission is unable to determine the appropriateness of the amounts reflected in this account at this time. Transco has filed additional information on this issue. Acceptance of Transco's filing is therefore conditioned upon further Commission review of the additional information concerning the methodology it

uses to compute its Account 191 balance for the surchange adjustment.

Finally, we note that Transco's filing also includes increases pursuant to area rate clauses in its contracts with producers. The Commission's acceptance of this filing shall not constitute a determination that any or all of the area rate clauses permit NGPA prices. Should it ultimately be determined, in accordance with the procedures prescribed in Order No. 23, as amended by subsequent orders prescribed in Docket No. RM79-22,[3] that a producer is not entitled to an NGPA price under an area rate clause, the refunds made by the producer to Transco shall be flowed through to the ratepayers in accordance with the procedures prescribed in Transco's PGA clause.

The Commission Orders:

(A) Transcontinental Gas Pipe Line Corporation's Third Revised Twenty-Second Revised Sheet Nos. 12 and 15, and Fifth Revised Sheet No. 16 to FERC Gas Tariff, Second Revised Volume No. 1; and Second Revised Twenty-Eighth Revised Sheet No. 121 to FERC Gas Tariff Original Volume No. 2 are accepted for filing and suspended, so that the filing shall become effective March 1, 1982, subject to refund and subject to the conditions set forth in the body of this order and in the paragraphs below.

(B) The issue of whether any of the costs of gas purchased by Transco should be denied pass-through because of fraud, abuse, or similar grounds pursuant to Section 601(c)(2) of the NGPA shall be subject to the final disposition of the proceedings in Docket Nos. TA81-1-29 and TA81-2-29.

---

[3] These orders were recently affirmed in *Pennzoil Company* v. *Federal Energy Regulatory Commission*, 645 F.2d 360 (5th Cir. 1981).

(C) Transco shall file within 15 days of the issuance of this order additional information supporting the storage costs contained in its filing.

(D) Acceptance is conditioned upon further Commission review of the additional information concerning the methodology Transco uses to compute its Account 191 balance for the surcharge adjustment.

(E) The petitioners listed in Appendix A to this order are permitted to intervene in this proceeding subject to the rules and regulations of the Commission; provided, however, that the participation of the intervenors shall be limited to matters affecting asserted rights and interests specifically set forth in their petitions to intervene and provided, further, that the admission of such intervenors shall not be construed as recognition that they might be aggrieved by any order entered in this proceeding.

By the Commission.

(SEAL)

/s/ KENNETH F. PLUMB
Kenneth F. Plumb,
Secretary.

APPENDIX A

Notices of Intervention:

North Carolina Utilities Commission

Public Service Commission of the State of New York

Petitions to Intervene:

Atlanta Gas Light Company

Brooklyn Union Gas Company

Columbia Gas Transmission Corporation

Consolidated Edison Company of New York, Inc.

Consolidated Gas Supply Corporation

Eastern Shore Natural Gas Company

Elizabethtown Gas Company

Frederick Gas Company, Inc.

Long Island Lighting Company

National Fuel Gas Supply Corporation

North Carolina Natural Gas Corporation

Philadelphia Gas Works

Process Gas Consumers Group

Public Service Company of North Carolina, Inc.

Public Service Electric and Gas Company

South Jersey Gas Company

Texaco Inc.

Transcontinental Gas Pipe Line Corporation

Virginia Electric and Power Company

Washington Gas Light Company

[Piedmont Natural Gas Company, Inc.]

[429] Q. (Mr. Stewart) In connection with these proceedings, has Transco entered into an agreement with the protestors with regard to the purchasing and the prices to be paid for any high cost gas that will be contracted for in the future? A. Not only with respect to high cost gas, but with respect to any gas that we purchase.

BY CHAIRMAN FANCHER:

Entered into a contract with whom, Mr. Stewart?

BY MR. STEWART:

A memorandum of understanding with regard to the protestors in the FERC hearing.

Q. (Mr. Stewart) What was that understanding? A. The understanding, obviously, speaks for itself, but in essence it states that Transco will not enter into any new contract unless the Commission is advised prior to that as to the reason why in excess of $5.00 There is also certain understandings with respect to whether contracts will contain market outs; whether they will contain take or pay provisions on the basis of reserves, not on deliverability. And with respect to meetings with those state commissions concerning Transco's purchase policy and market demand, long term supply demand, and any significant changes contemplated in our gas purchase policies. Also, with respect to the PGA, advance notices to the impact under the PGAs that will have a resale rates of Transco to its distributors.

[430] BY MR. STEWART:

Mr. Chairman, I would like to offer as Exhibit 2 to his testimony a copy of that memorandum.

BY MR. FRANKS:

We object to that, Mr. Chairman, completely. I don't think it should even be allowed to be proffered—a memo-

randum agreement somebody has with somebody else in North Carolina.

BY CHAIRMAN FANCHER:

I don't think it is material, Mr. Franks. I sustain the objection, but we will let him mark it for identification and make it a part of the record.

(THE MEMORANDUM WAS MARKED AS EXHIBIT 2 TO THE TESTIMONY OF MR. MULLENDORE FOR PURPOSES OF THE RECORD ONLY, AND APPEARS AS FOLLOWS:)

Exhibit 2

Docket Nos. TA81-1-29
TA81-2-29
TA82-1-29

TRANSCONTINENTAL GAS PIPE LINE CORPORATION

MEMORANDUM OF UNDERSTANDING

In order to achieve final resolution of the outstanding issues in the above-captioned proceedings, Transcontinental Gas Pipe Line Corporation (Transco) and the Public Service Commission of the State of New York and the North Carolina Utilities Commission (State Commissions) hereby agree to the provisions of this Memorandum of Understanding.

Preamble

During the pendency of these proceedings and reflecting changed conditions in both market demand and gas supply, Transco has adopted certain policies with respect to its purchase of gas under existing supply contracts and its negotiation of new supply contracts. These policies include the following:

a. Transco has exercised the "market-out" provisions of its deregulated gas contracts containing such provisions, at a price of $5.00 per MMBtu.

b. Transco has negotiated a reduction to $5.00 per MMBtu for deregulated gas purchased from its affiliate Transco Exploration Company under contracts not containing "market-out" provisions.

c. Transco has declined to enter into new contracts for uncommitted domestic reserves that do not contain "market-out" provisions at least as favorable to the purchaser as the "market-out" provisions invoked by Transco in May of 1982.

d. Transco has declined to enter into new contracts for uncommitted domestic reserves at an effective price in excess of the "market-out" level, currently computed by Transco at $5.00 per MMBtu.

e. Transco has used its best efforts to enter into new contracts for uncommitted domestic reserves on terms that minimize take obligations, including provisions that would not require take obligations prior to 1984 and provisions that limit annual takes to 15% of original recoverable reserves.

In light of the foregoing, the parties agree as follows:

I. Meetings

Transco shall initiate a meeting with each State Commission, either separately or jointly, on a semi-annual basis; such meetings shall be held, so far as practicable, no later than June 1 and December 1 of each year and shall have as their purpose a discussion of short- and long-term supply and demand, the measures anticipated by Transco to bring the two into balance, any significant changes then contemplated by Transco in its gas purchase policies and such information as is then available concerning its next change in rates under its PGA provision.

II. Advance Notice of PGA Filings

Approximately 15 days before the filing of each change in rates under its PGA provision, or sooner if the data are available, Transco shall furnish to the State Commissions an estimated summary of its next PGA rate filing. The summary shall include the total unit rate change, the projected surcharge to clear Account 191, an explanation of projected sales and total projected gas costs, and a volumetric and average unit cost breakdown of gas purchases by NGPA categories.

III. Notice of Significant Change in Gas Purchase Policies

In the event that Transco determines the need to alter the gas purchase policies specified in the Preamble hereof in a manner that would significantly affect the rates charged by Transco to its customers, it shall notify the State Commissions and its customers which are not affiliated with an interestate pipeline of the nature of and reasons for the change, and shall receive the views of such parties. Such notice (including a reasonable time for the parties to express their views) shall be given prior to the implementation of any change, unless it appears to Transco that delay incident to such advance notice would adversely affect it and the public it serves; in such case, Transco shall promptly notify the State Commissions and its customers which are not affiliated with an interstate pipeline of the change, either contemporaneously therewith or as soon as practicable after implementing such change. Nothing herein is intended to limit Transco's flexibility in implementing gas purchase policies which it believes will serve the best interests of itself and its customers.

IV. Access to New Contracts and Amendments

a. Transco shall provide to each State Commission on a semi-annual basis a summary of each new gas supply contract involving an estimated 5 Bcf or more of dedicated reserves; such summary shall show the date of contract, seller(s), field, estimated reserves, estimated date of initial delivery, applicable NGPA section(s), estimated initial price, existence of market-out provisions, and take-or-pay provisions. Transco shall also make available in its New York and Charlotte offices copies of each such contract for a period of one year for review by representatives of Transco's customers which are not affiliated with an interstate pipeline and the State Commissions.

b. Transco shall provide to each State Commission on a semi-annual basis a summary of each new amendment

relating to price or quantity of an existing gas supply contract which involves an estimated 5 Bcf or more of dedicated reserves. Transco shall also make available in its New York and Charlotte offices for a period of one year copies of each such amendment for review by representatives of Transco's customers which are not affiliated with an interstate pipeline and the State Commissions.

V. Termination of Proceedings, Withdrawal of Protests and Effective Date of Memorandum

Transco's agreement to this Memorandum is contingent upon the Commission terminating the instant proceedings without further hearings. Consequently, upon execution of this Memorandum, the State Commissions agree to withdraw their joint protests herein contingent upon the grant of Transco's motion to terminate these proceedings. This Memorandum shall be effective on the date that the Commission issues its order granting Transco's motion to terminate these proceedings. If such order shall be vacated in whole or in part on appeal, the provisions of this Memorandum shall be voidable at the election of any party hereto.

ACCEPTED AND AGREED TO THIS
25th DAY OF July, 1982
TRANSCONTINENTAL GAS PIPE LINE
CORPORATION

By /s/ THOMAS F. RYAN, JR.
Thomas F. Ryan, Jr.
Its Attorney

ACCEPTED AND AGREED TO THIS
27th DAY OF July, 1982
PUBLIC SERVICE COMMISSION OF THE
STATE OF NEW YORK

By /s/ RICHARD A. SOLOMON
Richard A. Solomon
Its Attorney

ACCEPTED AND AGREED TO THIS
27th DAY OF July, 1982
NORTH CAROLINA UTILITIES
COMMISSION

By /s/ MORTON L. SIMONS
Morton L. Simons
Its Attorney

[435] BY MR. STEWART:

We have no further questions of the witness.

BY CHAIRMAN FANCHER:

Mr. Stewart, those memorandums of agreement are not a part of the record, but just as a matter of curiosity, what are their dates? The one, in particular, where Transco is required to not buy any gas over $5.00 and the market out provisions and all of that stuff you were talking about.

BY MR. TAYLOR:

July 29, 1982, Mr. Chairman, the same date the petition——

BY MR. STEWART:

I would like for my witness to answer that.

BY CHAIRMAN FANCHER:

Well, you can read it.

BY MR. STEWART:

Yes, sir, the document speaks for itself. This is the date that it was signed, and I would like for Mr. Mullendore to clarify it.

BY CHAIRMAN FANCHER:

All right, that will be fine.

BY THE WITNESS:

I'm sorry, I did not understand the question.

BY CHAIRMAN FANCHER:

What was the date of that memorandum of agreement?

BY THE WITNESS:

It was entered into and signed on July 29, 1982, as a [436] result, Mr. Chairman, of a number of discussions

which we had with officials or chairman of the New York Public Service Commission and the North Carolina Utilities Commission, extending from a period of, I would say, late April, early May until this date.

BY CHAIRMAN FANCHER:

You say you have no further questions, Mr. Stewart?

BY MR. STEWART:

Yes, sir, that's right.

• • • • • • • • • • •

CROSS EXAMINATION

BY MR. TAYLOR:

Q. Mr. Mullendore, I believe yesterday you said you were familiar with the rules and regulations of FERC, is that right? A. That's correct.

Q. And with the Natual Gas Policy Act of 1978? A. Yes.

Q. Will you agree that FERC no longer has jurisdiction over the first sales of Section 107 gas? [437] A. That's correct.

Q. And the wells in question producing from this pool all produce Section 107 gas, do they not? A. I believe they have been certified as such, my recollection, and that certification has been accepted by the FERC.

Q. Yesterday you alluded to an agreement that Transco entered into with certain state commissions, do you recall that testimony? A. Yes, I do.

Q. What were those state commissions? A. The states of North Carolina and New York.

Q. Those commissions do not regulate Transco's resale rates, do they? A. No, they regulate the customers of

Transco, the distribution customers that are selling gas that Transco has sold within those states.

Q. But they do not regulate Transco's rates that it charges, do they? A. No. Exclusive jurisdiction of Transco with respect to its rates and operations, certificate matters with respect to construction, how a pipeline is operated, is in the FERC.

Q. That agreement you entered into on July 29, was not with FERC, was it? A. The staff of the FERC has joined in that. When it [438] was presented to the administrative law judge for certification to the FERC, my recollection is that the staff of the FERC joined in at that point.

Q. It was not required by the FERC, was it? Is there an order which required Transco to enter into the agreement signed on July 29, 1982? A. No, there is no such agreement. That memorandum of understanding grew out by the protest by an investigation—protest by the state commission, and an investigation that was ordered by the FERC into the matters that are contained in the commission's order.

Q. My question to you is that the memorandum of understanding was not required by an order of the Federal Energy Regulatory Commission, was it; yes, or no? A. No; no, it was not.

Q. The agreement was signed by Transco after Coastal Exploration complained to this Board in its letter of July 6, 1982; do you need to look at the file, or will you take that for granted? A. The date—the memorandum of understanding is dated July 29, 1982.

Q. Do you need to refer to the Oil and Gas Board's file to see that in fact that was after the letter of July 6, 1982 that Coastal wrote to the Board complaining about unratable takes? A. I will accept that statement.

[439] Q. And the agreement was signed by Transco the same date the petition in this docket was filed, was it not? A. If the record demonstrates that.

Q. You don't have any argument with that? A. Whatever the record demonstrates.

Q. Has FERC told you not to purchase Coastal Exploration's gas produced from these wells? A. No.

Q. Has FERC told you not to purchase gas or take gas ratably from these wells? A. What do you mean by ratably?

Q. Well, any understanding that you have of ratable take. I'm asking you is there an order from the Federal Energy Regulatory Commission which directs Transco not to take gas ratably from these wells? Is there such an order? A. Well, I don't want to quibble with the term ratable. There is no order of the commission that says we cannot take gas from these wells.

Q. And FERC has not told you not to comply with Rule 48 of this Board, has it? A. There is no order specifically issued from FERC that says not to comply with Rule 48.

Q. FERC has not told Transco that it cannot buy Coastal's share of gas produced from these wells on the same terms and conditions that it buys the operator's gas? [440] A. There is no specific order with respect to that.

Q. As a practical matter and a financial matter, Transco has never believed the challenges which have been made to its rates before FERC will have any significant effect on its financial position of net income; Transco has never believed that, has it? A. Would you repeat that?

Q. As a practical and financial matter, Mr. Mullendore, Transco has never believed that the challenges which have been made before FERC to its jurisdictional resale rates, will have any significant effect on Transco's financial posi-

tion or Transco net income? A. I don't believe I can agree with that.

Q. Are you a stockholder in Transco? A. Yes, sir.

Q. Do y'all publish quarterly financial statements? A. Yes, sir.

Q. Are you familiar with those financial statements? A. Yes, sir.

Q. Would you know it if you saw it? A. I'm sure I would.

Q. Let me hand you this document and ask you if you can identify that. A. Yes, I can.

Q. Do you recognize that to be the financial statements of the Transco companies, including Transcontinental Gas [441] Pipe Line for the first quarter of 1982? A. That's correct.

• • • • • • • • • • •

[442] Q. (Mr. Taylor) Mr. Mullendore, referring you to what has been marked as Exhibit for identification, will you turn to the 10th page that is entitled Notes to Condense Consolidated Financial Statement? A. Yes, sir, I have that.

BY CHAIRMAN FANCHER:

Mr. Taylor, who made that up? I suppose it's an audit report or something like that.

BY MR. TAYLOR:

Yes, it's a conventional report of Transco.

BY CHAIRMAN FANCHER:

Who did it?

Q. (Mr. Taylor) Mr. Mullendore, can you tell the Board under whose supervision this financial——

BY CHAIRMAN FANCHER:

I don't want to know under whose superivsion; I want to know who did it.

Q. (Mr. Taylor) Mr. Mullendore, who prepared this report for Transco? A. Transco Energy Company filed the report. Normally, it is handled by the financial department of Transco Energy, along with the legal department of Transco Energy.

Q. Transcontinental Gas Pipe Line Corporation is a subsidiary of Transco Energy, is that right? A. That is correct. I assume that Transco's accounting firm, which is Arthur Anderson Company, participated in the [443] financial notes relating to the various items that are contained in the report.

Q. You have seen this report before, haven't you? A. Yes, sir, I have.

Q. Do you believe it to be accurate? A. I have no reason to believe otherwise.

Q. Would you turn to the 10th page, which is marked Notes to Condense the Consolidated Financial Statement, and look in the second column? A. I have that.

Q. I believe that the second full paragraph refers to the Transco Pipe Line three semi-annual purchase gas adjustment filings that have been made with FERC, is that Correct? A. Yes, sir.

Q. And it goes on to refer to the protest, to which you previously testified have been filed by the State of New York and North Carolina, is that correct? A. That is correct.

Q. And that is the protest to your jurisdictional resale rates, correct? A. No, you are incorrect.

Q. All right, correct me. A. They are protests to the—not the resale rates, as such, they are protests to the pur-

chase gas costs that are passed through under the commission's regulations having to do with PGAs.

[444] Q. They would challenge the amount you can pay for your gas? A. They challenged, among other things, that item. I think that the protests probably speak for themselves. There were purchase patterns, there were take or pay, there were many other items of protest.

Q. Are the protests referred to in this paragraph on this page of your first quarterly report the same protests you referred to yesterday in your testimony from Mr. Stewart? A. Yes, sir.

Q. All right. Now, will you turn to the next page and read the first full sentence that appears in the first column?

A. (Reading) "Transco believes that the ultimate resolution of this matter will have no significant effect on its financial position on reported net income."

Q. And what matter is it referring to? A. It is referring to the protest by the New York and North Carolina Utilities Commissions concerning the pipeline company's three annual—semi-annual purchase gas adjustment filings for March and September of 1981 and March of 1982.

Q. And that continues to be Transco's belief? A. Well, it certainly is now that the memorandum of understanding is entered into.

Q. Now, yesterday Mr. Stewart examined you about Transco's sales and finances. In fact, Transco's total gas sales for the second quarter of 1982 are up as opposed to the [445] second quarter of 1981, are they not?

BY MR. STEWART:

Mr. Chairman, let the record reflect that there was no direct examination regarding finances. We will stipulate that we did have testimony concerning sales.

BY CHAIRMAN FANCHER:

I would have to agree with you, Mr. Stewart. Mr. Taylor, I really don't know what this has to do with Rule 48. Does New York produce any gas? Does Transco buy any gas in New York?

BY MR. TAYLOR:

Mr. Chairman, I'm just trying to make my record in response to several matters.

BY CHAIRMAN FANCHER:

Well, we are going to let you make your record, but I would like an answer; does New York produce any gas?

BY MR. TAYLOR:

It was my understanding of the testimony yesterday that the excuse they are offering for violating Rule 48 is this agreement with the states of New York and North Carolina, the——

BY CHAIRMAN FANCHER:

Okay, does North Carolina produce any gas? Do they buy any gas in North Carolina?

BY MR. TAYLOR:

That, I don't know, Mr. Chairman.

BY CHAIRMAN FANCHER:

Well, ask him.

[446] Q. Are you buying any gas in North Carolina? A. No.

Q. Are you buying any gas in New York? A. No. They produce gas. The State of New York produces gas, but we don't buy any.

Q. Well, in fact, the total sales of gas by Transco for the second quarter of 1982 was 236 billion cubic feet, were they not? A. I don't have that figure in mind.

Q. Let me hand you this next document and ask you if you can identify that? A. All right, that is a——

BY MR. STEWART:

Mr. Chairman, we—I'll just make a continuing objection and not waste the Board's time.

BY CHAIRMAN FANCHER:

Okay, let the record show that Mr. Stewart has a continuing objection to all of this line of testimony, but we want the record to be complete, Mr. Taylor, you may proceed. We gave him the same latitude yesterday and Tuesday.

Q. (Mr. Taylor) Mr. Mullendore, can you identify that document I've handed you? A. Yes, it's the second quarter report for 1982 of Transco Energy Company.

Q. And that is the company which owns Transcontinental Gas Pipe Line Corporation? [447] A. That's correct.

• • • • • • • • • •

[448] Q. Mr. Mullendore, yesterday in response to Mr. Stewart's examination you testified that there was a reduction in your market in May of 1982; do you recall that testimony? A. That is correct.

Q. But, in fact, for the second quarter of 1982, which was the months of April, May and June, there was a five percent increase in total gas sales by Transco as opposed to the second quarter of 1981, yes, or no? A. As I have stated, I don't have those figures in mind.

Q. If you could look on the fifth page of the second quarter report I have handed you, and if you would read

the first sentence in the second column. A. (Reading) "Transcontinental Gas Pipe Line's gas sales during the second quarter of 1982 were 236 billion cubic feet (BCF) compared with 225 BCF for the second quarter of 1981, an increase of five percent."

Q. That gas, in your testimony yesterday you said that the gas Transco buys is either used or store, is that correct? A. That is correct.

Q. What was done with the gas during the second quarter of 1982; was it used or stored, or used and stored? A. It was used and stored.

Q. And the storage facility if capable of holding 160 billion cubic feet of gas, isn't it? [449] A. That's correct.

Q. And that facility was at a record low at the end of the 1981-1982 winter season, wasn't it? A. No. I don't believe so.

Q. You don't believe what? A. I don't believe that it was at a record low.

Q. It was at a low of 40 percent of capacity at the end of the 1981-1982 winter season, wasn't it? A. I really don't know.

Q. Well, if you would turn back to the first quarter report and look on the fourth page. Do you have the fourth page? A. Yes.

Q. If you would look in the second colum and begin with the third sentence, please read that. A. Is that, "As a result . ."

Q. Yes, sir. A. (Reading) "As a result, total pipeline system gas storage was reduced from approximately 160 billion cubic feet at the beginning of the 1981-82 winter season to about 70 million cubic feet (40 percent of capacity) at the end of the period. Gas will be reinjected into storage during the summer months."

Q. And that's just what ya'll did; you injected gas in your storage system during the summer months, didn't you? A. We are injecting it.

Q. You are injecting it now? [450] A. Yes.

Q. It's not full, is it? A. It's about 88 percent full, Mr. Taylor. I think your question was "record low" and my recollection was that in the winter of 1976-77, at the end of that winter, our storage was substantially lower than 40 percent of our capacity.

Q. It was not a record low, but it was at 40 percent of capacity? A. Right.

Q. And it has taken quite a bit of gas to fill up your—reserve your storage facilities? A. Right. We would have liked to have seen the storage lower than that, because that permits us to buy more, or the customer to buy more, so that he can inject in to his storage capacity during the summer time those volumes.

Q. As of this date your storage facility is not full, is it? A. No, but you have to realize that if your storage capacity was at a 20 percent inventory level at this period of time, you would have been able to buy about another 15 or 16 billion cubic feet during the summer period. So, we like to see the inventory very, very low so that we can keep our purchases up in the summer time.

Q. I want to show you what has previously been introduced as Exhibit 8. It's a letter of June 17, 1982, on Getty Oil Company letterhead. If you will turn to the attached letter [451] of May 19, 1982, on Transco letterhead; do you see that? A. Yes.

Q. Would you read the second paragraph that appears on that page. A. (Reading) "Effective June 1, 1982, Transco will only take production attributable to the pro rata working interest of the above named signatory parties under the various Getty wells, and until further notice will

no longer take any gas being sold by the operator under the Operating Agreement."

Q. Now, would you read the next sentence? A. (Reading) "This action is being taken because volumes of gas which is currently available for delivery to Transco under its existing gas purchase agreement, substantially exceed the demand for gas in our market areas."

Q. Did Transco lose any markets during the second quarter of 1982, the three months ending June 30, 1982? A. Yes.

Q. What percentage of its market did it lose during the second quarter of 1982? A. I think I testified yesterday that we lost, according to the marketing department's survey, about 95 to 100 million cubic feet of gas daily.

Q. Which represents what percent? A. That would be about—and I equate it to an average daily flow—and that's about four or five percent of our average daily flow.

[452] Q. For your total market, or for a particular market? A. No, for the total market; total sales.

Q. Let me show you what was previously introduced as Exhibit 12, Mr. Mullendore. This is a letter of July 1, 1982, from Transco to the working interest owners in a number of wells, including the Sipp and the Rogers Well that we are here today on. Do you recognize this letter? A. Yes, sir.

Q. And I believe you saw it before it was actually sent out by Transco. A. Yes.

Q. Now, I believe in the letter of July 1, 1982, you are now offering to buy the gas—what we call the Operating Agreement gas, the gas of nonsignatory parties that you said you had no market for in your letter of May 19, 1982, is that correct? A. That is correct.

Q. Why did Transco have no market for the nonsignatory's parties gas on May 19, 1982, but suddenly had a

market for the gas on July 1, 1982? What changed? A. Nothing really changed. We met with some officials of Getty Oil Company. They reviewed the situation as they saw it as the result of our May 19, 1982 letter. They asked us if there was something that Transco could do to provide a market or transport the gas which belonged to the non-signatory parties. Those conversations, in my recollection, were on [453] two occasions.

Q. I'm asking you in the market place, Mr. Mullendore, what changed? A. Nothing. As a matter of fact, it got worse.

Q. The only thing that changed was the opportunity to buy gas for $5.00. A. Or transport it.

Q. Transco purchases gas from producers and resells for a profit, is that not correct? A. That's a—I don't want to quibble, but that is too simplicitious. We don't mark up gas. We don't buy for a nickel and sell it for eight cents.

Q. How do you make money? A. You make it on your rate base; on the investment that you make in rate base. We pass through only our—for purchase gas—only our actual cost. In general rate increases you don't make any mark up on natural gas. You make it on the allowed rate of return on your rate basis.

Q. Let me ask you this, Mr. Mullendore, your total gas sales were up in the second quarter of 1982, were they not? A. Right.

Q. And your average purchase price for MCF, that is the average price Transco paid per MCF to buy gas, was down over the first quarter of 1982, wasn't it? A. No. The average price, as a result of the March PGA had to have gone up, because purchase gas costs were up in [454] March.

Q. Would you refer to your quarter statement for the second quarter of 1982? A. All right.

Q. Now, what do you call the difference between your average purchase price per MCF and your average sales price per MCF? A. Well, the purchase price is simply the cost for the purchased gas.

Q. What do you call the difference in those two figures? A. I call them the transportation component in our rates; as the commission permits us to split out those costs between our demand and commodity portion of our rates.

Q. Let me—we may make some head-way, if you will look on page five of the quarterly report, the second report of 1982, you see it says Transcontinental Gas Pipe Line Corporation, and it's got some statistics there, right? A. Yes.

Q. And down under "Operations" it's got gas sales for the second quarter of 1982, 235.9 billion cubic feet, right? A. Yes.

Q. And it's got average sales price per MCF. A. Yes.

Q. And it says, $3.78? A. Right.

[455] Q. Now, that is the—what is the average sales price per MCF, is that what you are receiving in your resale of the gas? A. Yes, on an average among all three zones.

Q. Now, the next column says "Average Purchase Price Per MCF" doesn't it? A. Yes.

Q. Now, what does that mean? A. That's the average price that we pay the producer for the gas.

Q. And it says $3.13, right? A. Yes.

Q. Which is a 55 cents difference, is that right? A. Yes, that is correct.

Q. Now, the first quarter of 1982 your average sales price per MCF was not $3.78, was it? A. No, it was $3.80.

Q. Well, I believe if you will look at your own quarterly report for the first quarter of 1982, you will see it was

$3.52. If you would, refer to the first quarterly report. A. I'm sorry, I was looking at the——

Q. Well, look at the first quarterly report. Specifically, if you would look on page—on the fourth page it's got the same type of information there, doesn't it? A. Yes, I've got it now.

[456] Q. Now, for the first quarter of 1982, your average sales price per MCF was $3.52, right? A. That's what it says.

Q. And your average purchase price per MCF was $3.16? A. That's correct.

Q. Which was a difference of 36 cents, right?

BY CHAIRMAN FANCHER:

Mr. Taylor, I'm not going to stop you, but Mr. Stewart has a continuing objection to all of this testimony.

BY MR. TAYLOR:

Yes, sir, I understand.

BY CHAIRMAN FANCHER:

You objected yesterday to his attempt to the introduction of evidence with reference to price.

BY MR. TAYLOR:

Mr. Chairman, the purpose of this is simply to rebut the tail of woe of Transco.

BY CHAIRMAN FANCHER:

All right, sir. Let me ask Mr. Mullendore one question. You keep on referring to PGA, are you talking about the Professional Golf Association? (Laughter) Or do you want to identify that term for the record?

BY MR. MULLENDORE:

I'm sorry, Mr. Chairman, I get caught up in the vernacular of the FERC—Purchase Gas Adjustment is a term which is used at the FERC with specific reference to their rules which provide [457] for the flow through of purchased gas costs. I abbreviate it and call it PGA; Purchase Gas Adjustment. It's like on your electric bill, Fuel Adjustment Cost.

BY CHAIRMAN FANCHER:

Okay. I know what that is. Thank you. I just thought the record ought to be clear on that.

Q. (Mr. Taylor) Mr. Mullendore, getting back to your first and second quarter of 1982 report; for the first quarter of 1982, Transco's average purchase price per MCF was $3.16, is that correct? A. That's what it indicates, yes.

Q. For the second quarter it was $3.13, right? A. Right.

Q. Meaning that your average cost to buy gas from producers was down? A. That's what this would indicate, yes.

Q. And for the first quarter of 1982, your average sales price per MCF was $3.52, right? A. Yes.

Q. But for the second quarter your average sales price per MCF was $3.78? A. Yes.

Q. Meaning that the sales price was up but your acquisition price was down in the second quarter of 1982; yes, or no? A. That's what this would indicate, but it's not [458] quite that simple.

Q. I will let Mr. Stewart complicate that in his redirect.

BY MR. STEWART:

I would like the witness to be able to explain his answer to the question, Mr. Chairman.

BY CHAIRMAN FANCHER:

Let him explain in, Mr. Taylor.

BY MR. TAYLOR:

Yes, sir.

A. (The witness) My recollection is that we have—in our purchase gas adjustment filing there is called a deferred account. When producers file for, say, 107 certification with the board, and that is certified to the FERC, during the pendency of that all that the NGPA would admit to be paid, as to my recollection, the same as the 102 price. Then after the certification, the producer can go back and pick up from the date that he files for his well determinations, the difference in price. It may very well be that that had an impact, the deferred adjustment clause had an impact on what the purchase gas costs were recorded on the books from the first quarter to the second quarter. I know that there was about an 18 cent adjustment in purchase gas costs from the first quarter to the second quarter as a result of filing the purchase gas filing or PGA with the FERC. That 18 cent differential, because of the action of the deferred account as flowing through to resale [459] rates has been eliminated effective September 1. So, as of September 1, of this year, there is another 18 cent increase on resale rates solely through the action of the deferred account. I'm not familiar with how they actually keep the books and records and report on this. I'm simply saying that that is a very possible reason for the differential.

Q. Possible reason? You don't really know, do you? What you are telling the Board—— A. Well, I'm trying to explain to the Board. I'm trying to give some understanding here.

Q. Well, let's give some understanding to your figures. What this tell me is that in the first quarter of 1982 the

difference between your average cost to buy gas and the average price to sell gas was 36 cents in your favor, so to speak.

BY CHAIRMAN FANCHER:

Mr. Taylor, I'm sorry, but I'm just not going to let you ask him another question about prices. Let's get back to Rule 48, please. Can you do that?

Q. (Mr. Taylor) Mr. Mullendore, during the second quarter of 1982, when you experienced this 65 cent difference between your purchase and sales price was during the period when Transco was buying Coastal Exploration, Inc.'s gas from the wells in question on the same terms and conditions as it was buying the operator's gas, was it not? A. We were buying gas delivered to us by Getty. If [460] Coastal's gas was delivered by Getty to us in the volumes we were paying Getty for under their contract, then the answer to your question is, yes. But I have, no, you know, no independent knowledge that it belonged to Coastal, or who Coastal was at that time. It was being delivered by Getty.

Q. You knew that at least prior to July 1, 1982, that Getty was delivering and Transco was purchasing the gas of nonsignatory parties to Transco contracts, you know that, didn't you, Mr. Mullendore? A. I knew that they were delivering some gas that was in excess of their share under the contract. Who it belonged to, as your question was directed specifically to Coastal, I had no knowledge that it was Coastal's gas.

Q. My follow-up question was not that you knew it was Coastal's, but you knew that Transco was purchasing gas of nonsignatory parties, whoever they might be. A. Yes, unless there was a balancing arrangement of some type.

Q. Now, you testified yesterday in response to Mr. Stewart's questions, and correct me if I'm wrong, that it was not the custom and the practice to enter into contracts

which included the purchase of nonsignatory party gas or operating agreement gas, do you recall that testimony? A. I gave my opinion that it was not.

Q. And what was your opinion? A. That it was not customary.

[461] Q. That it was not customary to buy operating agreement gas under a contract? In other words, I'm trying to get the correct statement of what your opinion was.

BY MR. STEWART:

Mr. Chairman, the question as phrased incorrectly stated the question that Mr. Mullendore answered on direct.

Q. (Mr. Taylor) Mr. Mullendore, will you restate what your opinion was yesterday in response to the custom and usage question that Mr. Stewart put to you? A. It was not customary, in my opinion, to include nonsignatory gas insofar as contract minimums were concerned, I believe was the question.

Q. But that has not been true in Transco's experience in buying gas from the pool in question, has it? A. If you are making reference to other contracts in which we specifically agreed to take those as a part of the contract negotiation, there are certain contracts that we entered into that provided we would do so.

Q. There are at least 10 contracts with 10 different producers producing gas from the common pool that Transco entered into agreeing to buy gas other than the signatory parties gas. A. I don't know the number, but I said there are some other contracts.

Q. Do I need to let you go through the contracts, or do you agree?

[462] BY CHAIRMAN FANCHER:

No, sir, Mr. Taylor, let's don't do that.

A. (The witness) I agreed, Mr. Taylor, there are some other contracts. You put the number 10 on them, that is your number. I didn't count them. That's all I'm saying.

BY CHAIRMAN FANCHER:

Rule 48 doesn't say anything about whether or not the gas is under contract or not. It just says it shall be ratably taken and on a nondiscriminatory basis.

Q. (Mr. Taylor) Mr. Mullendore, the point is that Transco has not followed what claim is the custom and practice in contracting—in purchasing gas from this common pool. Transco has entered into contract under which it agrees to purchase Operating Agreement gas. A. I think I said yes to that; that we had entered into contracts.

Q. Are you familiar with the rules and regulations of this Board? A. No, I'm not.

Q. You are not at all familiar with the rules and regulations? A. No.

Q. You have been in the oil and gas business since 1958, and you have risen to the position you are in with Transco without ever having read and reviewed the rules and regulations of this Board? [463] A. I have not reviewed the rules and regulations of this Board.

Q. When entering into negotiations for gas contracts to buy gas in Mississippi, you had no knowledge of the rules and regulations of this Board? A. I have no knowledge of the rules and regulations, and specifically, Rule 48.

Q. Mr. Mullendore, at what point in time could an owner like Coastal owning a small undivided interest in these wells have been given what I call a Getty type contract, the same type contract Getty has covering these wells? At what point in time would Transco have given Coastal, with its interest, that type of contract? A. When the contract of Getty's was executed, and up to the time the market conditions changed.

Q. At what point in time was that? A. That was about mid May of this year. You are asking for a pinpoint in time, but somewhere before we determined that the market demand and the gas cost were such that we could no longer offer it.

Q. Now, Mr. Mullendore, you don't deny that it has been Transco's policy not to contract with owners of small undivided interests, but buy their gas through the operator's contract under the Operating Agreements in order to avoid the administrative burden of having to deal with the numerous owners of small undivided interests; that is a matter of policy that [464] Transco has followed, is it not? A. I'm not quite sure that I would agree with you. We don't have a policy of going out and seeking the names—I don't know how many people are involved, maybe 250 in this whole thing—of buying their gas. I don't believe that anyone who has, for instance, like Sabine, who has a small interest and who asked for a contract—I don't believe that we have ever turned them down of contracting for it specifically.

Q. Well, the point is that you testified that up to a point in mid May 1982, you would have given Coastal the same type contract Getty had, right? A. Yes.

Q. But the fact is, that in the Sabine contract you referred to, you gave Sabine that contract in December 1981, and they got $5.00, didn't they? A. Right.

Q. And they have got less than one percent in the Rogers Well. A. Right.

Q. Meaning that if it's that small, you get five bucks.

(No response)

Q. I have one more question for you. You would agree that in your opinion it is discriminatory for Transco to have purchased Coastal's gas on the same terms and conditions as it purchased the operator's gas, at least prior to

July 1, 1982, but then after that date to offer to purchase Coastal's gas [465] at the $5.00 price; is that discriminatory? A. No, I wouldn't agree with that. What is your definition of discriminatory?

Q. Is there a difference in those prices? A. There is a difference in the prices.

Q. There is a distinction in the prices. A. There is a difference in the prices.

BY MR. TAYLOR:

That's all the questions we have, Mr. Chairman.

• • • • • • • • • •

CROSS EXAMINATION

BY MR. TERRELL:

Q. Mr. Mullendore, you, of course, are familiar with Section 601-A of the NGPA? A. Yes.

[466] Q. And I believe—I just want to clarify that you stated that the first sale of gas produced from the well that is the subject of this petition is exempt from FERC jurisdiction by Section 601-A of the NGPA? A. The sale.

Q. The first sale, as defined in the Act. Did, when Transco inform the operators that it was purchasing only the signatory parties gas produced from the well, the subject of this petition, do you know if either Transco or the operator caused abandonment proceedings to be filed under the Natural Gas Act? A. Well, I have no knowledge, but I think I would know that—I assumed they served papers on Transco. I would assume they did not file for abandonment.

Q. Are abandonment proceedings necessary? A. For the producers?

Q. Correct. A. Well, that's a legal question. My answer would be probably no, insofar as the sale.

Q. As to the sale of the nonsignatory parties gas? A. Yes.

BY MR. TERRELL:

Thank you, sir.

BY MR. WATTERS:

No questions.

• • • • • • • • • • •

[470] REDIRECT EXAMINATION

BY MR. STEWART:

Q. Mr. Mullendore, you responded that the first sales of this gas was not subject to jurisdiction of the FERC. Were Transco's purchases of this gas subject to the jurisdiction of the FERC? A. Yes, I think that if you will refer to Appendix B of the commission's order suspending Transco's PGA filing—purchase gas adjustment filing of that order, being dated February 28, 1981, you will note the items which Transco had to supply to the FERC concerning contracts between Transco and Suppliers of Section 107 gas, the geographic origin of such supplies, including well numbers, whether any wells were jointly owned and the name of the other sellers and the other buyers, volumes, pricing mechanism, maximum ceiling prices; not only with respect to those that we had assigned, but also with [471] respect to what we were negotiating for at the time. All that information was asked to be supplied—ordered to be supplied.

BY MR. TAYLOR:

Mr. Chairman, may the record reflect the petitioner, Coastal, has a continuing objection to this line of questioning?

BY CHAIRMAN FANCHER:

Yes, sir, the record may so reflect.

Q. (Mr. Stewart) Mr. Taylor also asked you to read out of the second quarter financial report, which was Exhibit 4, a statement concerning the position of Transco with regard to the effect of the PGA filings, again refer to the financial report for the first quarter of 1982, which would include the months of January, February and March of 1982, with regard to statements concerning the effect of the PGA filings on Transco Energy's financial position. When would the statement for the first quarter of 1982 normally come out? A. It would come out probably in April or May of 1982.

Q. At that time had discussions with the protestors of thos PGA filings been entered into with regard to resolutions by the memorandum of agreement?

BY CHAIRMAN FANCHER:

Mr. Stewart, I think we know that that was just done a few days ago, you know, but go ahead and let him answer the question. You asked him that yesterday.

A. We entered into, in my recollection—I can't really say whether it was before it came out or during the preparation, [472] or after it came out, Mr. Stewart. I know that depositions—my deposition was taken by the FERC staff, the North Carolina Commission and the New York Commission, I believe, in early April of 1982. Subsequent to that deposition, we entered into discussions with those commissions concerning the possible settlement of the issues in the PGA case. I can't pinpoint whether it was before, after or during, but I can say that from that point on until the consummation of the memorandum of understanding we had at least five, and perhaps more, across the table discussions with the respective commissions, and concern-

ing potential settlement of those issues. We had the lawyers involved, and that took an awful long time.

BY CHAIRMAN FANCHER:

I'll agree with that. Mr. Stewart, we keep on talking about commisions of North Carolina and the commission of New York. I would like for the witness to identify those commissions and their jurisdiction. Are they regulatory commissions on the production of oil and gas, or are they similar to the Mississippi Public Service Commission which regulates price? I don't know why Mr. Taylor didn't do that, but I would just like to know.

A. (The witness) The Public Service Commission of the State of New York and the North Carolina Utilities Commission regulate our distributor customers resale and operations of their distribution systems.

BY CHAIRMAN FANCHER:

So, they deal directly with distribution and price at a retail or a whole level, not with production?

[473] A. To my knowledge there is no production of oil or gas in the state of North Carolina. With respect to the New York Commission, Mr. Chairman, I can't tell you whether they regulate that production aspect of it or not.

BY CHAIRMAN FANCHER:

Okay. If you don't know, you don't know.

A. Well, I don't know.

BY CHAIRMAN FANCHER:

Well, that's good enough.

A. But I do know that they are charged—like I suppose the Public Service Commission of the State of Mississippi, whatever their term is, with regulating their rates and protection of the consumer.

BY CHAIRMAN FANCHER:

They are not doing a very good job of it. Go ahead.

Q. (Mr. Stewart) Mr. Mullendore, you indicated that gas is currently being injected into storage capacities of Transco and that Transco has at present already stored up to 88 percent of its storage capacity? A. That's the latest figure I have, Mr. Stewart.

Q. When is it projected that the storage capacity will be completely full? A. Out Oakford storage is full, without the exception of perhaps, two weekends of injection. You have to realize that as storages fill up, pressures increase. The injecting capability as pressures within the reservoir increase, the [474] ability to force the gas down into the completed reservoirs, likewise, decrease. We currently estimate that based on customers nominations into storage and our storage will be filled probably by the middle of October, if not sooner. That depends on market; it depends on ability to inject everything that the customer asks to be injected. I have not checked the operations aspect of where they are with injection capability or anything like that. I do know that because of the fringe months, and I'm talking about the months of September and October, that we will get occasional cold snaps where the customers will call for their gas out of storage. They can inject or withdraw out of storage on a daily basis.

Q. Is Transco currently producing all of the gas that it is contractually required to produce even though it still has some storage capacity? A. We are not purchasing all of the gas that we are contractually authorized or obligated to purchase.

Q. What will happen to your daily take of gas when your storage capacity is at 100 percent? A. They will be reduced.

Q. Mr. Taylor asked whether or not Transco buys gas and then resells it for a profit.

BY CHAIRMAN FANCHER:

If they didn't do that, Mr. Stewart, they would go out of business, you know.

BY MR. TAYLOR:

May the record continue to reflect that the [475] petitioner, Coastal, objects to this line of questioning?

BY CHAIRMAN FANCHER:

Yes, sir.

Q. (Mr. Stewart) Is Transco's return on its investment regulated? A. Yes.

Q. Who is it regulated by? A. By the FERC.

Q. To what extent is it regulated? A. It's totally regulated.

• • • • • • • • • •

Excerpts from the Mississippi State Oil and Gas Board order establishing gas allowables for April 1, 1982 to October 1, 1982

MISSISSIPPI STATE OIL AND GAS BOARD
JACKSON, MISSISSIPPI

In Re: Docket Number 29-82
Order Number 163-82

GAS ALLOWABLES FOR APRIL 1, 1982, TO OCTOBER 1, 1982

This day there came on for hearing before the State Oil and Gas Board Docket Number 29-82 concerning the fixing of the gas allowables in the hereinbelow listed fields in accordance with Statewide Rules, and the State Oil and Gas Board finding that due, proper and legal notice of the hearing of said docket at this meeting has been given in the manner, way form and within the time provided by law and prescribed by rules and regulations of this board and that due and sufficient proofs of publication are on file being duly advised in the premises and the Board finds that the gas allowables should be set for the months of April 1, 1982, to October 1, 1982, for the purpose of preventing waste and for the protection of correlative and coequal rights of the owners in the gas pools in said fields.

IT IS THEREFORE HEREBY ORDERED BY the State Oil and Gas Board that the gas allowables for the hereinbelow fields be and the same are hereby set for the months of April 1, 1982, to October 1, 1982, and said allowables are allocated among the producing wells in said fields as follows:

• • • • • • • • • •

HOSSTON-HARPER GAS POOL
ALLOWABLES FOR APRIL 1, 1982, TO
OCTOBER 1, 1982 – 44,914 MCF/DAY
ALLOCATION FACTOR – 7.80 MCF/ACRE

COMPANY AND WELL	WELL NO.	ASSIGNED ACREAGE	DELIVER-ABILITY (FORM 4-A)	DAILY ALLOWABLE MCF
GETTY OIL COMPANY				
Rogers 28-11	1	640	7,100	7,100
Sipp 20-9	1	640	4,100	4,100
HARKINS & COMPANY ET AL				
Bd. of Sup. UN 16-11	2	640	5,044	5,044
Barnes Unit 9-10	1	640	5,013	5,013
Fortenberry UN 10-11	1	640	5,015	5,015
Tolar Unit 15-6	1-LT	640	5,013	5,013
Dale Unit 17-8	1	640	5,080	5,080
Dale Unit 8-10	1	640	5,049	5,049
TOMLINSON INTERESTS, INC.				
J. C. Williamson et al	1	640	3,500	3,500
TOTAL				44,914

EAST MORGANTOWN FIELD
HARPER GAS POOL
ALLOWABLES FOR APRIL 1, 1982, TO
OCTOBER 1, 1982 – 28,250 MCF/DAY
ALLOCATION FACTOR – 6.30 MCF/ACRE

COMPANY AND WELL	WELL NO.	ASSIGNED ACREAGE	DELIVER-ABILITY (FORM 4-A)	DAILY ALLOWABLE MCF
GETTY OIL COMPANY				
F. W. Buckley 33-6	1-U	640	3,550	3,550
W. Morgan 9-14	1	640	4,800	4,800
TOMLINSON INTERESTS, INC.				
Board of Education	1-UT	640	5,000	5,000
H. L. Beacham	1	640	5,000	5,000
Clinton V. Morgan	1	640	5,000	5,000
Pitard & Probil	1	640	3,000	3,000
Mrs. Leona W. Fortenberry	1	640	4,600	4,600
TOTAL				28,250

Office-Supreme Court, U.S.
FILED
MAY 30 1985
ALEXANDER L. STEVAS,
CLERK

(9)

No. 84-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and
COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

BRIEF FOR THE APPELLANT

JOHN MARSHALL GROWER
(Counsel of Record)
JEFFERSON D. STEWART
R. WILSON MONTJOY II
BRUNINI, GRANTHAM, GROWER & HEWES
1400 First National Bank Building
Post Office Drawer 119
Jackson, Mississippi 39205
Telephone: (601) 948-3101

R. V. LOFTIN, JR.
THOMAS E. SKAINS
DAVID A. GLENN
TRANSCONTINENTAL GAS PIPE LINE
CORPORATION

Attorneys for Appellant

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

8 4 1 0 7 6

QUESTIONS PRESENTED

1. By enacting the Natural Gas Policy Act of 1978 did Congress intend to cede to the states its preemptive jurisdiction over interstate pipelines and their purchase and transportation of natural gas for resale in interstate commerce, thereby overruling *Northern Natural Gas Co.* v. *State Corporation Commission*, 372 U.S. 84 (1963)?

2. Does Mississippi's attempted regulation of interstate pipeline companies' purchase of "high cost" gas constitute an impermissible burden on interstate commerce under present market conditions?

PARTIES TO THE PROCEEDING

In addition to the parties named in the caption, Wiley Fairchild, Rodney Fairchild, W. R. Fairchild Construction Company, Ltd., Getty Oil Company, Inexco Oil Company, and Tomlinson Interests, Inc. are producers who have appeared in opposition to Transcontinental Gas Pipe Line Corp. at all stages of the proceedings.

The following persons personally appeared before the Mississippi State Oil and Gas Board at the initial proceeding: Susan W. Clements Lay, Lane Petroleum Corp., Louis G. Ridgeway, Daniel E. Herlihy, and Bryant M. Allen.

Transcontinental Gas Pipe Line Corporation is a wholly-owned subsidiary of Transco Energy Company. Affiliates of Transcontinental Gas Pipe Line Company are Border Gas, Inc. and NESP Supply Corp.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
PARTIES TO THE PROCEEDING	ii
TABLE OF AUTHORITIES	v
OPINIONS BELOW	1
JURISDICTION	2
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED	2
STATEMENT OF THE CASE	3
A. Background and Overview of the Federal Statutory Scheme over Natural Gas Sold and Transported in Interstate Commerce	3
B. FERC's Assertion of Jurisdiction Over the Purchasing Practices of Transco since the Enactment of the NGPA	14
C. Mississippi's Attempt to Regulate Transco and its Purchases	16
SUMMARY OF THE ARGUMENT	20
I. Preemption by the NGA and NGPA	20
II. The Impermissible Burden and Discrimination Against Interstate Commerce	22
ARGUMENT	23
I. Efforts by Mississippi to Force Transco to "Ratably" Purchase High Cost Gas From Producers with No Contract are Preempted	23
A. The Pervasive Federal Interest in the Interstate Gas Market	24

TABLE OF CONTENTS continued

Page

B. Mississippi's Ratable Purchase Requirement is an Obstacle to the Accomplishment of Congressional Objectives Underlying the Natural Gas Act and NGPA 30

C. The Direct Conflict with Ongoing FERC Regulation of Interstate Pipelines 33

II. Mississippi's Enforcement of Rule 48 Against an Interstate Pipeline Impermissibly Burdens and Discriminates Against Interstate Commerce 34

A. The Applicable Test Under the Commerce Clause 35

B. The "Practical Effect" of Mississippi's Ratable Take Order 38

C. Increases In Total Pipeline Takes from Mississippi Caused by Rule 48 Operate as a Prohibited Discriminaton Against Interstate Commerce 40

D. The Impact of Rule 48 On the Cost of Gas in the Interstate Market Constitutes an Impermissible Burden 43

E. Constitutional Regulatory Alternatives Do Exist 46

CONCLUSION 48

APPENDIX 1a

TABLE OF AUTHORITIES

CASES: Page

Arkansas Electric Cooperative Corp. v. *Arkansas Public Service Commission*, 461 U.S. 375 (1983) . 21, 32, 34

Atchison, Topeka & Santa Fe Railway Co. v. *Public Utilities Commission*, 346 U.S. 346 (1953) 2

Bacchus Imports, Ltd. v. *Dias*, 104 S.Ct. 3049 (1984) . 36, 41

Barnwell, Inc. v. *Sun Oil Co.*, 249 Miss. 398, 162 So.2d 635 (1964) 47

Best & Co. v. *Maxwell*, 311 U.S. 454 (1940) 37

California v. *Southland Royalty Co.*, 436 U.S. 519 1978) 29

Champlin Refining Co. v. *Corporation Commission*, 286 U.S. 210 (1932) 23, 24, 47

Cities Service Gas Co. v. *FERC*, 627 F.2d 1027 (10th Cir. 1980) 45

Cities Service Gas Co. v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950) 44, 45

Energy Reserves Group, Inc. v. *Kansas Power & Light Co.*, 459 U.S. 400 (1983) 29, 46, 48

Exxon Corp. v. *Eagerton*, 462 U.S. 176 (1983) .... *passim*

Exxon Corp. v. *Governor of Maryland*, 437 U.S. 117 (1978) 41

Foster-Fountain Packing Co. v. *Haydel*, 278 U.S. 1 (1928) 41

FPC v. *Corporation Commission*, 362 F. Supp. 522 (W.D. Okla. 1973), *aff'd*, 415 U.S. 961 (1974) . 22, 36, 44

FPC v. *East Ohio Gas Co.*, 338 U.S. 464 (1950) 24

FPC v. *Louisiana Power & Light Co.*, 406 U.S. 621 (1972) 22, 33, 34

H. P. Hood & Sons v. *Dumond*, 336 U.S. 525 (1949) .. 35

TABLE OF AUTHORITIES continued

Page

Hughes v. *Alexandria Scrap Corp.*, 426 U.S. 794 (1976) 37-38

Hughes v. *Oklahoma*, 441 U.S. 322 (1979) 36, 37, 41

Hunt v. *Washington Apple Advertising Commission*, 432 U.S. 333 (1977) 37, 41, 43

Interstate Natural Gas Co. v. *FPC*, 331 U.S. 682 (1947) 24

Kassell v. *Consolidated Freightways Corp.*, 450 U.S. 662 (1981) 22, 44

Lewis v. *B. T. Investment Managers, Inc.*, 447 U.S. 27 (1980) 37

Maryland v. *Louisiana*, 451 U.S. 724 (1981) .. 21, 30-31, 33

Missouri v. *Kansas Natural Gas Co.*, 265 U.S. 298 (1924) 35

New England Power Co. v. *New Hampshire*, 455 U.S. 331 (1982) 45

Northern Natural Gas Corp. v. *State Corporation Commission*, 372 U.S. 84 (1963) ..... *passim*

Oklahoma v. *FERC*, 494 F. Supp. 636 (W.D. Okla 1980), *aff'd*, 661 F.2d 832 (10th Cir. 1981), *cert. denied*, 457 U.S. 1105 (1982) 27

Pennsylvania v. *West Virginia*, 262 U.S. 553 (1923) . *passim*

Philadelphia v. *New Jersey*, 437 U.S. 617 (1978) . 22, 36, 48

Phillips Petroleum Co. v. *Wisconsin*, 347 U.S. 672 (1954) 4, 24

Pike v. *Bruce Church, Inc.*, 397 U.S. 137 (1970) .. 36, 46, 48

Public Service Commission v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983) 26, 29

Raymond Motor Transportation, Inc. v. *Rice*, 434 U.S. 429 (1978) 44

TABLE OF AUTHORITIES continued

Page

Shell Oil Co. v. *FERC*, 566 F.2d 536 (5th Cir. 1978), *aff'd*, 440 U.S. 1273 (1979) 29

South-Central Timber Development, Inc. v. *Wunnicke*, 104 S.Ct. 2237 (1984) 45, 49

Southern Pacific Co. v. *Arizona*, 325 U.S. 761 (1945) . 43

Sporhase v. *Nebraska*, 458 U.S. 941 (1982) 41, 45

Tenneco, Inc. v. *Sutton*, 530 F. Supp. 411 (M.D. La. 1981) 40

United Gas Pipe Line Co. v. *FPC*, 385 U.S. 83 (1966) 22, 34

West v. *Kansas Natural Gas*, 221 U.S. 229 (1911) .. 40

CONSTITUTION AND STATUTES:

United States Constitution:

Article I, Section 8, clause 3 (Commerce Clause) .. 2, 34, 45-46

Article VI, Section 2 (Supremacy Clause) 2

Natural Gas Act, 15 U.S.C. §§ 717-717w 2

Section 1, 15 U.S.C. § 717 2

Section 1(a), 15 U.S.C. § 717(a) 3

Section 1(b), 15 U.S.C. § 717(b) 3, 34

Section 1(c), 15 U.S.C. § 717(c) 4

Section 2a(6), 15 U.S.C. § 717a(6) 4

Section 4(b), 15 U.S.C. § 717c(b) 2, 4

Section 5(a), 15 U.S.C. § 717d(a) 2, 4

Section 7(b), 15 U.S.C. § 717f(b) 13

Section 7(c), 15 U.S.C. § 717f(c) 34

Natural Gas Policy Act, 15 U.S.C. §§ 3301-3432 2

Sections 101-109, 15 U.S.C. §§ 3311-3319 9

TABLE OF AUTHORITIES continued

	Page
Section 101(b)(9), 15 U.S.C. § 3311(b)(9)	2, 10
Section 105, 15 U.S.C. § 3315	11
Section 106(b), 15 U.S.C. § 3316(b)	11
Section 107(c), 15 U.S.C. § 3317(c)	2
Section 121, 15 U.S.C. § 3331	10
Section 121(a), 15 U.S.C. § 3331(a)	2
Section 121(b), 15 U.S.C. § 3331(b)	2, 10
Section 122, 15 U.S.C. § 3332	2, 10
Section 302, 15 U.S.C. § 3362	12
Section 303, 15 U.S.C. § 3363	12
Section 315, 15 U.S.C. § 3375	2, 13
Section 315(a), 15 U.S.C. § 3375(a)	13
Section 315(b), 15 U.S.C. § 3375(b)	13
Section 501, 15 U.S.C. § 3411	2, 10
Section 503(a)-(d), 15 U.S.C. § 3413(a)-(d)	2
Section 503(b), 15 U.S.C. § 3413(b)	11
Section 503(c), 15 U.S.C. § 3413(c)	29, 46
Section 503(c)(1), 15 U.S.C. § 3413(c)(1)	11
Section 503(c)(3), 15 U.S.C. § 3413(c)(3)	11
Section 505, 15 U.S.C. § 3415	28
Section 505(a)(1), 15 U.S.C. § 3415(a)(1)	12
Section 601, 15 U.S.C. § 3431	2, 12
Section 601(a)(1)(A) or (B), 15 U.S.C. § 3431(a)(1)(A) or (B)	13
Section 602(a), 15 U.S.C. §3432(a)	2, 14, 29, 46
56 Stat. 83 (1942)	4
61 Stat. 459 (1947)	4
68 Stat. 36 (1954)	4
76 Stat. 72 (1962)	4
91 Stat. 4-10 (1977)	5

TABLE OF AUTHORITIES continued

	Page
92 Stat. 3117 (1978)	7
92 Stat. 3174 (1978)	7
92 Stat. 3289 (1978)	7
92 Stat. 3350 (1978)	7
Miss. Code Ann. 53-1-1 (1972 and Supp. 1984)	2, 40, 47
Miss. Code Ann. 53-1-1 to -101 (1972 and Supp. 1984)	17
MISCELLANEOUS:	
18 C.F.R. § 274.401(a)	11
18 C.F.R. Parts 157 and 284	34
123 Cong. Rec. 11482 (1977)	5
124 Cong. Rec. 28633 (1978)	32
124 Cong. Rec. 28661 (1978)	27
124 Cong. Rec. 29101 (1978)	27
124 Cong. Rec. 29108 (1978)	6, 7, 12, 28
124 Cong. Rec. 29116 (1978)	27
124 Cong. Rec. 30021 (1978)	27
124 Cong. Rec. 30028 (1978)	26
124 Cong. Rec. 38350-503 (1978)	7
124 Cong. Rec. 38361 (1978)	9
124 Cong. Rec. 38366 (1978)	28
Energy Information Administration, U.S. Dept. of Energy, *Statistics of Interstate Natural Gas Pipeline Companies,* Table 20 (1983)	39
Energy Information Administration, U.S. Dept. of Energy, *Structure & Trends in Natural Gas Wellhead Contracts* 38 (1983)	38-39

TABLE OF AUTHORITIES continued

Page

42 Fed. Reg. 6789 (1977) 5

42 Fed. Reg. 6791 (1977) 5

42 Fed. Reg. 18053 (1977) 5

44 Fed. Reg. 61950 (1979) 10

48 Fed. Reg. 25264 (1983) 16, 21

49 Fed. Reg. 50637 (1984) 10

50 Fed. Reg. 114 (1985) 16, 34

50 Fed. Reg. 3801 (1985) 16, 34

FPAS NGPA Inf. Serv. § 21, pp. 1-2 11

FPAS NGPA Inf. Serv. § 601:220, pp. 3-4 13

H.R. 4051, 80th Congress, 1st Sess. (1947) 26

H.R. 4099, 80th Congress, 1st Sess. (1947) 26

H.R. 1758, 81st Congress, 1st Sess. (1949) 26

H.R. 6645, 84th Cong., 2nd Sess. (1956) 26

H.R. Rep. No. 709, 75th Cong., 1st Sess. 1-2 (1937) ... 3

H.R. Rep. No. 543, 95th Cong., 1st Sess. (1977) 5, 6, 28

H.R. 8444, 95th Cong., 1st Sess., Part IV (1977) 6

H.R. Rep. 1752, 95th Cong., 2nd Sess. (1978) ..... *passim*

Pierce, *Natural Gas Regulation, Deregulation & Contracts,* 68 Va. L. Rev. 63 (1982) 38-39

S. Rep. No. 1162, 75th Cong., 1st Sess. (1938) 3

S. 1498, 81st Congress, 1st Sess. (1949) 26

S. Rep. No. 436, 95th Cong., 1st Sess. (1977) 6, 28

TABLE OF AUTHORITIES continued

Page

S. Rep. 1125, 95th Cong., 2nd Sess. (1978) 14

S. Conf. Rep. No. 1126, 95th Cong., 2d Sess. (1978) . 29, 46

S. 2104, 95th Cong., 1st Sess. (1977) 6

Statewide Rule 48 of the State Oil and Gas Board of Miss. ..... *passim*

Transcontinental Gas Pipe Line Corporation, 23 FERC ¶ 61292 (1983) 15

Transcontinental Gas Pipe Line Corporation, 14 FERC ¶ 61204 (1981) 14

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and
COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

BRIEF FOR THE APPELLANT

OPINIONS BELOW

The opinion of the Mississippi Supreme Court (J.S. App. A), is reported at 457 So. 2d 1298 (Miss. 1984).[1] The opinion of the Circuit Court of Hinds County, Mississippi (J.S. App. B, 59a-103a) is not reported. The order of the Mississippi State Oil and Gas Board (Board) (J.S. App. C, 104a-113a) is not reported.

---

[1] Jurisdictional Statement (J.S.) Appendix A, 1a-58a.

JURISDICTION

This case involves a challenge to the constitutionality of the Board's enforcement of a "ratable take" rule against an interstate pipeline, Transcontinental Gas Pipe Line Corporation (Transco). The Mississippi Supreme Court entered its judgment upholding the challenged regulation and order on September 5, 1984. (J.S. App. E, at 115a). A petition for rehearing was filed by Coastal Exploration, Inc. and was denied on October 5, 1984. (J.S. App. D, at 114a). Transco filed a notice of appeal to this Court on November 30, 1984 (J.S. App. F, at 116a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(2). *Atchison, Topeka & Santa Fe Railway Co.* v. *Public Utilities Commission*, 346 U.S. 346, 348 (1953). Probable jurisdiction was noted March 25, 1985.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Supremacy Clause of the Constitution, U.S. Const. art. VI, cl. 2, and the Commerce Clause, U.S. Const. art. I, § 8, cl. 3, are set forth in J.S. App. G, p. 119a.

To some extent, all of the Natural Gas Act (NGA), 15 U.S.C. §§ 717-717w, and the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301-3432, are involved in the Supremacy Clause question. Sections 1, 4(b), and 5(a) of the NGA[2] and Sections 101(b)(9), 107(c), 121(a) and (b), 122, 315, 501, 503(a)-(d), 505(a), 601 and 602(a) of the NGPA[3] are reproduced in Appendix A hereto.

Miss. Code Ann. § 53-1-1 (1972) and Statewide Rule 48 of the State Oil and Gas Board of Mississippi are set forth in J.S. App. G, 128-9a.

---

[2] 15 U.S.C. §§ 717, 717c(b), 717d(a).

[3] 15 U.S.C. §§ 3311(b)(9), 3317(c), 3331(a) and (b), 3332, 3375, 3411, 3413(a)-(d), 3415(a), 3431, 3432(a).

STATEMENT OF THE CASE

A. Background and Overview of the Federal Statutory Scheme over Natural Gas Sold and Transported in Interstate Commerce.

1. The Natural Gas Act.

To understand the current scheme of federal control over natural gas, one must return to the year 1938 and the enactment of the Natural Gas Act. The NGA was the product of a Congressional decision to protect consumers against exploitation at the hands of "natural gas companies." It was prompted by a perceived regulatory "gap":

> Sales for resale, or so-called wholesale sales, in interstate commerce (for example, sales by producing companies to distributing companies) . . . have been considered not local in character and, even in the absence of Congressional action, not subject to State regulation. The basic purpose of the present legislation is to occupy this field in which the Supreme Court has held that the States may not act.

H. R. Rep. No. 709, 75th Cong., 1st Sess. 1-2 (1937); S. Rep. No. 1162, 75th Cong., 1st Sess. 1-2 (1937).

Section 1(a), 15 U.S.C. § 717(a), sets forth the intent of the Congress in enacting the NGA:

> It is declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and sale thereof in interstate and foreign commerce is necessary in the public interest.

Section 1(b), 15 U.S.C. § 717(b), sets forth a clear demarcation between the state and federal regulatory domains. The federal government through its "Commission"[4] would have exclusive control over three areas:

---

[4] Federal Power Commission (FPC) or its successor, the Federal Energy Regulatory Commission (FERC).

(1) The transportation of natural gas in interstate commerce;

(2) The sale in interstate commerce of natural gas for resale for ultimate public consumption; and

(3) Natural gas companies[5] engaged in such transportation or sale.

States were left with their traditional jurisdiction over (1) production or gathering of natural gas; (2) local distribution companies and their retail sales of natural gas; and (3) wholly intrastate sales and transportation.[6]

Under Section 4(b) and 5(a), 15 U.S.C. §§ 717c(b) and 717d(a), the Commission is expressly charged with preventing a natural gas company under its jurisdiction from making or granting "any undue preference or advantage to any person or subject[ing] any person to any undue prejudice or disadvantage," or maintaining "any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service."

2. Congressional Action Leading to the NGPA.

Federal statutory jurisdiction over the natural gas market remained essentially unchanged until 1977[7] when, due to the critical shortage of natural gas in the interstate

---

[5] A "natural gas company" is expressly defined in the NGA as a person engaged in the transportation of natural gas in interstate commerce, *or* the sale in interstate commerce of such gas for resale. 15 U.S.C. §717a(6).

[6] Section 1(c), 15 U.S.C. § 717(c), as amended in 1954. 68 Stat. 36 (1954).

[7] There were revisions to the Natural Gas Act in 1942, 1947, 1954 and 1962 which, except as noted in Note 6, *supra*, are not germane to the jurisdictional question presented. 56 Stat. 83 (1942); 61 Stat. 459 (1947); 68 Stat. 36 (1954); 76 Stat. 72 (1962). The debate over federal jurisdiction of independent producer sales to interstate pipelines was settled in 1954. *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954).

market, the Emergency Natural Gas Act of 1977 (ENGA) was passed.[8] This statute provided a two month period in which the President could declare a natural gas emergency and require any interstate pipeline or producer to contract with an interstate pipeline for emergency supplies of natural gas without subjecting those supplies (or the sellers) to regulation under the NGA. President Carter declared a natural gas emergency on February 2, 1977 but, on April 1, 1977, terminated the program.[9]

In April, 1977, President Carter declared "the moral equivalent of war" on the energy crisis that had gripped the nation since 1973 and challenged Congress to pass a comprehensive national energy plan. 123 Cong. Rec. 11482 (1977). The goal of the NGA, to ensure adequate supplies of natural gas nationwide at just and reasonable rates, had not changed. However, Congress recognized that, in order to meet this goal, the bifurcated, interstate/intrastate gas market that had been created by regulation under the NGA had to be eliminated. Further, the regulatory structure for wellhead pricing had to be revised in order to keep pace with market dynamics and allow producers adequate incentives to explore for new supplies of natural gas.[10] *See* H.R.

---

[8] Pub. L. 95-2, §§1-14, 91 Stat. 4-10 (1977).

[9] Proclamation No. 4485, 42 Fed. Reg. 6789 (1977); Exec. Order No. 11,969, 42 Fed. Reg. 6791 (1977); Proclamation No. 4495, 42 Fed. Reg. 18053 (1977).

[10] Senator Henry Jackson, quoting from a letter dated September 8, 1978 from Mr. Charles Curtis, the Chairman of FERC, summarized the regulatory problems and causes to the Senate during the debates on the NGPA:

> FERC's current case load is substantial. It's backlog unacceptably large. This circumstance derived from a number of causes. First, the regulatory scheme, as presently implemented, is particularly cumbersome, and appears incapable of keeping pace with the dynamics of the market. Second, this commission's predecessor, the Federal Power Commission, was singularly unsuccessful in obtaining from Congress

Rep. No. 543, 95th Cong., 1st Sess. 136-9 (1977); S. Rep. No. 436, 95th Cong., 1st Sess. 2-4 (1977).

The House of Representatives passed a bill which imposed a permanent, uniform wellhead price policy for all natural gas produced in the United States and an incremental pricing mechanism for pass-through of these price increases to the end-user.[11]

On the other hand, the Senate passed a bill which eliminated federal wellhead price controls on new natural gas in the continental United States within two years, imposed interim ceilings based on the price of No. 2 fuel oil, and continued price controls on flowing interstate gas without any controls on interstate gas.[12]

Both House and Senate versions had created a permanent extension of certain provisions of ENGA[13] and changes to the rate-making authority of the Commission which were designed to reduce the regulatory burden on natural gas producers.[14]

---

adequate resources to perform the Commission's duties. Third, the evolution of the various producer-price methodologies, changing from producer-by-producer regulation to area rates, and lastly, to national rates for different gas vintages has created its own set of administrative problems and uncertainty in the marketplace. But perhaps the most difficult aspect which attends the administration of the current regulatory system is grounded in the bimodel character of the market and the limited regulatory reach of the Commission under the Natural Gas Act. These deficiencies place great stress on the regulatory system and add substantially to the administrative and enforcement duties of the Commission.

124 Cong. Rec. 29108 (1978).

[11] H.R. 8444, 95th Cong., 1st Sess., Part IV (1977).

[12] S. 2104, 95th Cong., 1st Sess. (1977).

[13] The House version proposed that ENGA be extended to apply to both interstate and intrastate pipelines. The Senate proposed that it apply only to interstate pipelines. The Senate version was adopted in the NGPA.. H.R. Rep. 1752, 95th Cong., 2d Sess. pp. 103-06 (1978).

[14] *See* H.R. Rep. No. 543, 95th Cong., 1st Sess., 162-64, 166-71 (1977). S. Rep. No. 436, 95th Cong., 1st Sess. 8, 10-14 (1977).

The House and Senate bills were submitted to a joint conference in September, 1977.[15] Over a year later, Congress passed the NGPA as part of its National Energy Act, a package of legislation intended to create a "comprehensive national energy policy."[16] The NGPA was, by far, the most controversial and complex legislation of the package.[17] It was the epitome of compromise between the two completely different programs proposed by the House and the Senate.

---

[15] In his discussion of the final committee report, floor leader Henry M. Jackson stated to the Senate:

> Because of the very wide differences in approach between the House and Senate passed natural gas bills, the conferees were faced with a considerable task in attempting to reconcile the two bills. We chose to proceed by developing an outline of a proposed compromise rather than working with statutory language. After we concluded our deliberations, the staff was instructed to draft the conference report and joint statement of managers. On July 30, 1978, the Chairman of the conference, the Honorable Harlee O. Staggers, circulated the staff's draft. That draft was reviewed by Mr. Curtis [Chairman of FERC] and Ms. Hollis, among others. Ms. Hollis and the general counsel of the Commission, Mr. Robert Nordhaus, participated with members of the staff in the further development of the final version of the conference report. It is that final version which has been presented to the Senate for its consideration.

124 Cong. Rec. 29108 (1978).

[16] 124 Cong. Rec. 38350 (October 14, 1978). That package included the Natural Gas Policy Act of 1978, Pub. L. No. 75-621, 92 Stat. 3350, *et seq.;* the Public Utility Regulatory Policy Act of 1978, Pub. L. No. 95-617, 92 Stat. 3117, *et seq.;* the Energy Tax Act of 1978, Pub. L. No. 95-618; 92 Stat. 3174, *et seq.;* and the Power Plant and Industrial Fuel Use Act of 1978, Pub. L. 95-620, 92 Stat. 3289, *et seq.*

[17] The House of Representatives debated and voted on the entire energy package rather than each separate act. Of the members who voiced their reasons for opposition to the National Energy Act, all singled out the NGPA as the primary reason for their opposition. Of those who opposed the NGPA, a clear majority listed the complexity of the NGPA and the added bureaucracy it would bring as a primary reason for their opposition. *See* 124 Cong. Rec. 38350-503 (1978).

3. The Natural Gas Policy Act of 1978.

The NGPA is divided into six titles: Wellhead Pricing (Title I); Incremental Pricing (Title II); Additional Authorities and Requirements (Title III); Natural Gas Curtailment Policies (Title IV); Administration, Enforcement and Review (Title V); and Coordination with the Natural Gas Act; Effect on State Laws (Title VI).

The NGPA's intended effect on the interstate gas market was summarized by Rep. John Dingell [18] in his presentation of the NGPA Conference Report to the House:

> First, by delaying price deregulation until the mid-1980's the bill allows sufficient time for gradual interim pricing mechanisms to raise the price of new gas from historically underpriced levels to a point where the market can clear. However, because the bill does not "vintage" gas by year, it does not create incentives for producers to withhold sale of gas in anticipation of qualifying for deregulation in the future.
>
> Second, windfall profits are avoided. Phased deregulation in the mid-1980's under this bill will avoid a transitional bump in prices which would be caused by deregulation and would generate windfall profits. In addition, the bill specifically excludes withheld gas from qualifying for deregulation. I believe the manner in which the bill's deregulation mechanisms will operate, including a safety-net mechanism permitting rapid Presidential or congressional reimposition of controls, overcomes the objections on which my previous opposition to deregulation was based. Yet the bill offers the incentives which supporters of deregulation have advocated in the past. For these reasons, I believe the bill to be a workable compromise of competing concerns.

---

[18] Rep. Dingell was Chairman of the Subcommittee on Energy and Power of the House Committee on Interstate and Foreign Commerce, one of the conferees signing the Conference Report, and a "floor leader" during the debates on this bill.

> Third, incremental pricing is substituted for wellhead price controls as a market ordering device. The delay of deregulation is necessary to enable this substitute mechanism to eliminate present day market distortions prior to deregulation.
>
> Incremental pricing will put an upper limit on the prices pipelines will be willing to pay for gas supplies. The ability of gas-hungry interstate pipelines to average-in comparatively small volumes of deregulated supplies of new gas with far greater volumes of cheaper old gas would result in a bidding war between pipelines for new gas supplies. This bidding war would be exacerbated by current pipeline rate regulation which ties profitability to throughput volumes. Thus, the price of deregulated new gas would be bid to excessively high levels as pipeline managers seek to maximize throughput volumes and thereby pipeline profits.
>
> Incremental pricing solves this problem by focusing initial price increases on the pipelines' most price sensitive customers: historically underpriced industrial users. By allowing the delivered price of these customers gas to rise to the level of alternative fuels, incremental pricing limits the ability of the pipeline to pass through high prices for new gas. Constrained by the limits this places upon the pass through of increased costs of gas, pipelines will be forced to bid responsibly for deregulated supplies of gas or face a loss of customers and an associated reduction in throughput volumes and profits.

124 Cong. Rec. 38361 (1978).

Sections 101-109 of Title I of the NGPA, 15 U.S.C. §§ 3311-19, establish "maximum lawful ceiling prices" for "first sales" of eight major categories covering all natural gas.[19] Unlike regulation under the NGA, in which wellhead

---

[19] Eligibility to collect up to the maximum lawful prices of the newly created categories was (and is) not automatic. The producer must first obtain a determination from the appropriate "jurisdictional agency" that the gas it intended to sell meets FERC's qualifications for that particular

prices were determined after extensive cost-of-service rate hearings, maximum lawful ceiling prices for "first sales" are fixed by statute and subject to statutorily fixed rates of escalation. Section 101(b)(9), 15 U.S.C. § 3311(b)(9), also makes it clear that gas prices for first sales would be determined by existing and future contracts if the contracts called for prices below any applicable maximum lawful ceiling price.

Sections 121 and 122, 15 U.S.C. §§ 3331-32, establish a phased elimination of wellhead price ceilings for the new gas classifications and "standby price control authority" for reimposition of price ceilings if deemed necessary by either the President or Congress. Under Section 121(b), price ceilings on certain "high cost gas" were eliminated November 1, 1979, the effective date of the first stage of the Commission's incremental pricing regulations.[20] As of January 1, 1985, wellhead price ceilings were lifted on still more categories of new gas.[21] Section 122 authorizes either the President or Congress to reimpose price controls on these deregulated categories at any time between July 1, 1985 and June 30, 1987 for a period of 18 months.

Title V addresses the administration, enforcement, and review powers of both FERC and state "jurisdictional agencies" under the NGPA. Section 501, 15 U.S.C. § 3411, makes it clear that the FERC is primarily responsible for the administration and enforcement of the Act.[22] It pro-

---

category. These qualification procedures are governed by Section 503 of the NGPA and FERC regulations promulgated thereunder.

[20] 44 Fed. Reg. 61950 (1979).

[21] 49 Fed. Reg. 50637 (1984).

[22] In his September 8, 1978 letter to Senator Jackson, Mr. Charles Curtis, the Chairman of FERC, states:

> Under the NGPA, the Commission is to be vested with an array of administrative and enforcement devices traditionally given to regula-

vides the necessarly rule-making and enforcement authority for FERC to carry out its functions and further gives FERC the discretion to delegate to any state agency its functions under the NGPA with respect to *intrastate* gas.[23]

Section 503 sets forth the administrative scheme under which determinations are to be made as to which pricing category or categories apply to gas production from a particular well. Section 503(c)(1), 15 U.S.C. § 3413(c)(1), provides:

> A Federal or State agency having regulatory jurisdiction with respect to the *production* of natural gas is authorized to make determinations referred to in subsection (a) of this section.

(emphasis added). Those determinations, however, must be made in accordance with the form and content established by FERC. Further, the state implementation of such determinations were subject to FERC approval.[24] Finally, all determinations are also subject to review and reversal by FERC.[25]

> tory agencies. Principal among these are the enforcement mechanisms which will allow the Commission to compel compliance with the Act through injunctive actions in the courts and to improve civil and criminal penalties for violations of the requirements of the Act or the regulations of Commission. In a number of respects, these mechanisms are more substantial than those available to the Commission at present under the Natural Gas Act. Moreover, the Commission has been given certain administrative powers, which exceed those currently available to the Commission under existing laws.

FPAS NGPA Inf. Serv. § 21 at 1-2.

[23] The only delegation under this section made by FERC to date has been "the authority to receive reports required by . . . an intrastate pipeline pursuant to sales made under Section 105 and 106(b) of the NGPA." 18 C.F.R. § 274.401(a).

[24] Section 503(c)(3), 15 U.S.C. § 3413(c)(3), 18 C.F.R. Part 274.

[25] Section 503(b), 15 U.S.C. § 3413(b).

In Section 505(a)(1), 15 U.S.C. § 3415(a)(1), FERC is given authority to intervene into any state agency proceedings "relating to the prorationing of, or other limitations upon, natural gas *production* which is conducted by any State agency having regulatory jurisdiction over the *production* of natural gas." (emphasis added).

Title VI of the NGPA sets forth the effect of this legislation on existing federal and state law. Section 601, 15 U.S.C. § 3431, establishes the NGPA's "Coordination with Natural Gas Act." It provides that Natural Gas Act jurisdiction and regulations which would have applied *solely by reason of* (1) "first sales" of gas classified under "high cost" and other new gas categories created in Title I; (2) transportation of gas under Section 311(a) or; (3) transportation of gas pursuant to the emergency purchase or allocation authority of Sections 302 and 303 are not longer applicable to those transactions. As Senator Jackson explained to the Senate:

> Generally speaking, except for gas which is committed or dedicated to interstate commerce on the day before the date of enactment, the current utility-type regulatory mechanisms would be terminated. Thus, it would no longer be incumbent on *producers* to obtain certificate authorization for new sales in interstate commerce, dedication of new gas reserves would not be required nor would a *producer* need abandonment permission from the Commission to allow it to sell gas to another upon conclusion of the contractual term. Also, in the case of sales of gas not previously committed or dedicated to interstate commerce occurring after the date of enactment, tariff filings and rate increase applications would be dispensed with.

124 Cong. Rec. 29108 (1978) (emphasis added).

In lieu of the NGA-type regulation, less burdensome regulatory controls were created in the NGPA. FERC Chairman Curtis noted some of the changes in his September 8, 1978 letter to Senator Jackson:

> The provisions of the Natural Gas Policy Act exempting from Natural Gas Act-type regulation gas that would otherwise be subject to Commission regulation limit the authority of the Commission to control the entry of natural gas into interstate commerce and to require continuation of service until the Commission authorizes the abandonment of such sales under section 7 [717f] of the Natural Gas Act. . . .
>
> While the NGA authorization for these controls would cease under the NGPA, a substitute mechanism of more limited scope would be available to the Commission in the exercise of its general grant of rule-making authority to implement the substantive provisions of section 110 [3320] (processing and treating costs flow-through), section 315 [3375] (contract duration, right of first refusal, filing of contracts and agreements) and section 503 [3413] (eligibility for ceiling prices).
>
> The Commission's exercise of abandonment authority under section 7 of the NGA provided supply security that was essential during the period of pipeline construction and is today a valuable regulatory tool to prevent diversion of interstate gas to higher priced intrastate markets. Natural Gas qualifying for NGA exemption under 601[3431](a)(1)(A) or (B) need not obtain Section 7(b) abandonment authorization. The supply security function of section 7 of the NGA would be achieved by the Commission's use of its authority under section 315(a) of the NGPA to set the minimum duration of new contracts, within certain stated limits. Subsection (b) of section 315 gives the Commission another tool with which to preserve interstate pipeline reliance on a source of supply. . . . [S]ection 315(b) provides a right of first refusal to the pipeline whose contractual right to purchase has expired for any presently committed or dedicated gas which, after date of enactment, would no longer be subject to the Natural Gas Act. The embedded costs of transportation facilities installed by the contracting pipeline when service commenced should create adequate incentive for the pipeline to hold on to the gas supply. The right of first refusal, in essence, assures that the pipeline will have the opportunity to do so.

FPAS NGPA Inf. Serv. § 601:220, at 3-4.

Section 602(a), 15 U.S.C. §3432(a), grants the states authority to establish even lower maximum lawful ceiling prices for gas produced and sold within the state. In enacting Section 602(a), the Conference Committee stated:

> The conference agreement provides that nothing in this Act shall effect the authority of any State to establish or enforce any maximum lawful price for sales of gas in intrastate commerce which does not exceed the applicable maximum lawful price, if any, under Title I of this Act. This authority extends to the operation of any indefinite price escalator clause. The Congress enacts this provision with a recognition that it is ceding its authority under the commerce clause of the Constitution to regulate prices for such production to affected States.

H.R. Rep. 1752, 95th Cong., 2nd Sess. 124-25 (1978); S. Rep. 1126, 95th Cong., 2nd Sess. 124-25 (1978).

B. FERC's Assertion of Jurisdiction Over the Purchasing Practices of Transco since the Enactment of the NGPA.

The NGPA has certainly modified the method by which FERC regulates the interstate gas market. However, the exclusive nature of its jurisdiction over interstate pipelines such as Transco and their purchasing practices has never been in doubt as far as FERC was concerned.

As early as February, 1981, FERC established proceedings to investigate charges that the purchases of high cost gas by interstate pipelines, including Transco, were not just and reasonable under Section 4 and 5 of the Natural Gas Act or Section 601(b) of the NGPA.[26]

---

[26] See J.A. 174-92. The initial order by FERC found that the proposed tariff sheets filed by Transco had "not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory, or otherwise unlawful." J.A. 185, 14 FERC ¶ 61204 (1981).

In a subsequent order dealing with consumer protests of Transco's rate filing, the FERC stated:

> In a number of other orders accepting PGA filings, we have interpreted allegations of fraud, abuse or similar grounds as challenges to the pipeline company's purchasing practices. We find that similar treatment is warranted for the complaint of the Attorney General of the State of New York because the essence of his complaint is that Transco paid too much for its gas. According to the Attorney General, the resulting rates are not just and reasonable within the meaning of Sections 4 and 5 of the Natural Gas Act. Consistent with our actions in the previous cases, we hereby institute a proceeding under Section 5 of the Natural Gas Act for the purpose of considering the Attorney General's protest regarding prices and purchasing practices of Transco.

Transcontinental Gas Pipe Line Corporation, 23 FERC ¶ 61292 (1983).

On June 2, 1983, FERC noticed its "Inquiry Into Purchasing Practices of Interstate Pipelines" and stated:

> Some producers have alleged that the interstate pipelines are engaging in discriminatory purchasing practices against some producers, which is resulting in denial of access to natural gas markets, drainage and waste. The Commission is unclear as to whether these allegations have merit. Pipelines' current purchasing practices may be, at least in part, a reasonable response to reduced market demand and an attempt to prevent further price increases to their natural gas customers.
>
> The Commission continues to maintain that State regulation of the purchasing practices of interstate pipelines impermissibly invades the Commission's jurisdiction. In enacting the Natural Gas Act, Congress intended to establish a comprehensive scheme of federal regulation of interstate pipelines. Major reasons for establishing the federal scheme were prevention of undue discrimination by interstate pipelines by virtue

> of their monopsony and monopoly positions, filing the regulatory gap where States could not act effectively, and protecting natural gas consumers from unreasonably high gas prices. 15 U.S.C. §§ 717, 717c, 717d (1976); Federal Trade Commission, Utility Corporations, S. Doc. 92, 70th Cong., 1st Sess. (1936). Congress charged the Commission with the authority and responsibility to administer the Act.
>
> In light of the foregoing, the Commission believes that it is incumbent on it to examine the situation and determine whether Commission action is warranted.

48 Fed. Reg. 25264 (1983).

Most recently, FERC has issued two notices pertaining to an extensive rule-making proceeding designed to review every facet of its regulation of interstate pipelines, in light of the Congressionally-mandated transition to competitive pricing of natural gas at the wellhead" and the "implications of partial wellhead decontrol on its regulation of interstate pipelines."[27] Among the significant issues currently being addressed in this proceeding are (1) whether FERC can or should require jurisdictional pipelines to transport "non-owner shippers'" gas; (2) what, if any, new factors should be considered in establishing a pipeline's resales and transportation rates which would increase competition both at the wellhead and at the burner tip; and (3) how should FERC treat the "risk" factor of a jurisdictional pipeline's rates so that it does not inappropriately bias either pipelines or their customers nor hinder competiton at the wellhead or the burner tip.

C. Mississippi's Attempt to Regulate Transco and its Purchases.

Oblivious to the scope of this federal regulatory scheme, the Mississippi State Oil and Gas Board felt compelled to

---

[27] 50 Fed. Reg. 114 (1985); 50 Fed. Reg. 3801 (1985).

respond to the plea of a local producer that had misjudged its market.

On July 29, 1982, after receiving correspondence indicating that Transco was no longer willing to purchase gas which it was not contractually obligated to take, Coastal Exploration (Coastal) filed a petition with the Board seeking to have it require Transco to purchase Coastal's gas under the same terms and conditions that the well operators were receiving for the sale of their gas under long-term contracts with Transco.[28] R. 19-26. Coastal was a working interest owner without a sales contract in four wells producing gas from a single pool which had been classified as "high cost" gas under the NGPA.

The Board was statutorily created by and is charged with the duty of effectuating and enforcing the Mississippi conservation statutes.[29] In 1952, the Board had enacted, along with other general, statewide rules, its Rule 48:[30]

> Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, or producers shall purchase without discrimination in favor of one owner, operator, or producer against another in the same common source of supply.

Transco objected to the Board's assertion of jurisdiction over an interstate pipeline. R 75. At the Board hearing, the parties stipulated that Transco was a pipeline subject to the jurisdiction of the FERC. J.A. 147-49. Transco also put on evidence that, due to rapid escalation of its average

---

[28] Other non-operators without contracts, as well as the operator who were selling their gas under long-term contracts, intervened in the proceeding at the Board.

[29] Miss. Code Ann. §§ 53-1-1 to -101 (1972 and Supp. 1984). The Mississippi Conservation Act was enacted, essentially in its present form, in 1948.

[30] Rule 48 is entitled "Ratable Take". Prior to the NGPA, this rule was admittedly invalid. It had been enforced only one previous time by the Board. *See* J. S. App. A at 52a.

gas costs and the recent loss of some of its industrial resales customers to alternative fuels, it already had under contract 520 million feet of gas per day more than it could re-sell. J.A. 160. Consequently, it could not purchase any gas it was not already contractually obligated to take without increasing take-or-pay exposure and the threat of additional loss of its resales market. J.A. 161-64. Transco also testified that it had just entered into a "Memorandum of Understanding" to settle the proceedings begun before FERC in February of 1981 challenging its purchase of high cost gas. J.A. 206-11.

The Board's response to Transco's "problems" was perhaps best revealed in the following statement by the Board's Chairman at its hearing:

> I really don't want to cut you off, Mr. Stewart. I would like for you to make all of the record that you would like to, but insofar as I'm concerned, the other Board members may have different ideas, but I don't think the trials and tribulations and the troubles of Transco has anything to do with any part of this hearing. Like I say, Rule 48 is what we are here to talk about. And whether they can sell it or can't sell it, Rule 48 doesn't say anything about that.

J.A. 165.

Transco representatives further testified that Transco was not seeking to contract for any new reserves due to excess deliverability but, as a concession to one of the operators, it had recently made an offer to Coastal and the other working interest owners in these particular wells to either dedicate their gas to Transco under a long-term contract but at a lower price [31] or Transco would transport their gas for sale to another purchaser. J.A. 66-69, 224.

---

[31] Transco's offer was to purchase this gas consistent with its "Memorandum of Understanding," *i.e.*, at $5.00 per mmbtu, subject to further reductions if it continued to experience market clearing problems in its resale areas.

Coastal testified that it had refused to accept this offer because it felt Transco was discriminating against it and other small interest owners by continuing to pay Getty Oil $7.90 per mmbtu for gas being produced from the same well and reservoir.[32] J.A. 75-78.

The Board found Transco in violation of Rule 48 for discriminating against small interest owners and causing drainage, and imposed the following order:

> Transcontinental Gas Pipe Line Corporation ("Transco") is hereby ordered immediately and forthwith to comply with Statewide Rule 48 of the State Oil and Gas Board of Mississippi in its purchases of gas from the said Harper Sand Gas Pool in Greens Creek and East Morgantown Fields, and that, if Transco chooses and elects to take and purchase gas produced from the said common pool and the wells producing therefrom, Transco shall ratably take from the wells producing from the common pool; and shall ratably take and purchase gas without discrimination in favor of one owner, operator or producer against another in the said common source of pool; and, specifically, in the event it so chooses and elects to take and purchase gas produced from the said common pool, Transco shall ratably take and purchase without discrimination in favor of the operators Getty and Tomlinson against Coastal, the Fairchilds, and Inexco.

J.S. App. C at 112(a).

On appeal, the Mississippi Supreme Court affirmed the Board's order to the extent that it required Transco to take and purchase gas ratably from all owners in a common pool. However, it reversed the Board's obvious attempt to force Transco to purchase at a higher price on the grounds that the Board had no statutory authority under the Mississippi conservation statutes to regulate prices. J.S. App.

---

[32] The $7.90 price was the redetermined price due under Getty's long-term contract which had been executed in August 1980. J.A. 34-36.

A at 48a-55a. Nevertheless, the Mississippi Supreme Court made it clear that it did not consider state regulation of an interstate pipeline's purchase prices to be constitutionally barred. J.S. App. A at 50a. It further warned that a pipeline must offer to ratably purchase gas in Mississippi from all owners in a common pool "in good faith [on] reasonable terms, including a reasonable price, determined by reference to prevailing market conditions and other appropriate economic considerations," in order to comply with the Board's Rule 48. J.S. App. A at 55a.

SUMMARY OF THE ARGUMENT

I. Preemption by the NGA and NGPA.

Mississippi's ratable take rule is unconstitutional when applied to interstate pipelines because it is preempted by the pervasive scheme of federal regulation over sales and transportation in interstate commerce. In 1938, Congress, through the NGA, determined that sales and transportation in interstate commerce were of national concern and that federal regulations would completely occupy the field. In 1963 this Court voided a Kansas ratable take order because of the "imminent possibility of collision" with the pervasive and exclusive federal jurisdiction over interstate pipelines and the intricate relationship between their cost structures and eventual cost to wholesale customers. *Northern Natural Gas Corp.* v. *State Corporation Commission,* 372 U.S. 84, 92 (1963).

The NGPA did nothing to eliminate or restrict the federal domain or interest over sales and transportation of gas in interstate commerce. It did supplant the ineffective utility-type regulation of wellhead sales with a less burdensome scheme which was intended to complement natural market pressure from competitive fuels. However, the legislative history gives no indication of any Congressional intent to allow states to intrude into a federal domain that

has been established since 1938. In fact, it is clear that the NGPA was designed to expand the federal scheme into the intrastate market to the extent necessary to affect the "national energy policy." Under the revised scheme, states are to maintain their traditional jurisdiction over drilling and production and have limited authority to mandate lower prices on intrastate sales.

Because of current market conditions, Mississippi's mandate to ratably purchase deregulated gas not under contract will directly increase Transco's acquisition costs and will affect the quantities or mix of gas which Transco must resell. This is a direct interference with FERC's exclusive jurisdiction over Transco's costs and resales rates, even more intrusive than the interference condemned by this court in *Maryland* v. *Louisiana*, 451 U.S. 724 (1981), and *Exxon Corp.* v. *Eagerton*, 462 U.S. 176 (1983).

Mississippi's Rule 48 also stands as an obstacle to the accomplishment of Congressional objectives underlying the NGPA. The phased elimination of ceiling prices and regulation under the NGA over certain incentive categories of gas is a federal decision to forego direct regulation. Such a decision to forego regulation is no less pre-emptive in its effect than enacting regulations. *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, 461 U.S. 375 (1983). Mississippi's attempt to assert jurisdiction over "deregulated" gas is also inimical to a primary purpose of the NGPA, the elimination of bifurcated markets for natural gas. If producing states have the authority to force additional deregulated gas into interstate commerce during a surplus, it is natural to assume that they will attempt to withhold it under that same authority during the next shortage.

Finally, Mississippi's order is in direct conflict with FERC's "Inquiry into Purchasing Practices of Interstate Pipelines," 48 Fed. Reg. 25264 (1983), and its inherently broad transportation jurisdiction over interstate pipelines.

FPC v. *Louisiana Power & Light Co.*, 406 U.S. 621 (1972); *United Gas Pipe Line Co.* v. *FPC*, 385 U.S. 83 (1966). The effect of Mississippi's order has also been put at issue in Transco's latest tariff filing before FERC.

II. The Impermissible Burden and Discrimination Against Interstate Commerce.

Under present market conditions, Mississippi's ratable take order leaves Transco with no choice but to decrease its takes from contract sellers in order to begin purchasing gas from non-contract producers in Mississippi. Because of high percentage take-or-pay contracts and Mississippi's refusal to regulate production on market demand, this will necessitate a reduction in contract purchases in other states to accommodate the increased takes from Mississippi. This is precisely the type of discriminatory attempt to achieve economic protection for local interests from a national problem which the Court has previously condemned. *Philadelphia* v. *New Jersey*, 437 U.S. 617, 624 (1978); *Pennsylvania* v. *West Virginia*, 262 U.S. 553 (1923).

Even if Transco could reduce its contract purchases just under existing Mississippi contracts, such a reduction will expose the pipelines to increased claims under their long term supply contracts for contract gas not taken. Under current federal regulation, pipelines' "take-or-pay" costs are capitalized and a return thereon passed through to the consumer. The result will directly increase the price paid for gas by the interstate consumer. Such state-imposed price burdens on interstate commerce are impermissible. *FPC* v. *Corporation Commission*, 362 F. Supp. 522 (W.D. Okla. 1973), *aff'd*, 415 U.S. 961 (1974). *See*, *Kassell* v. *Consolidated Freightways Corp.*, 450 U.S. 662 (1981).

Because Rule 48 has been deemed applicable only to deregulated gas, J.S. App. A at 29a, partial enforcement will

also result in greater pipeline takes of deregulated gas and a reduction in purchases of less costly regulated gas. This constitutes yet another unconstitutional price burden on the interstate consumer.

Moreover, the Board has wholly failed to utilize an obviously constitutional regulatory alternative which would not burden interstate commerce. Direct regulation and allocation of production is the proper method of eliminating drainage between competing producers. *Champlin Refining Co.* v. *Corporation Commission*, 286 U.S. 210 (1932). Therefore Rule 48 violates the Commerce Clause.

ARGUMENT

I.

Efforts by Mississippi to Force Transco to "Ratably" Purchase High Cost Gas From Producers with No Contract are Preempted.

The standards of preemption by which this state action must be judged are well established. *See, Exxon Corp.* v. *Eagerton*, 462 U.S. 176, 182 (1983). It is respectfully submitted that Mississippi's ratable take order is preempted under these standards in three ways.

First, the federal interest in and regulation of sales and transportation of natural gas for resale in interstate commerce is still so dominant and pervasive as to preclude the enforcement of any state laws in this field. Second, the state's mandate to purchase non-contract gas stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress in promulgating the Natural Gas Act and the NGPA. Finally, Mississippi's ratable take order directly invades and conflicts with FERC's assertion of jurisdiction over the purchasing practices of interstate pipelines.

A. The Pervasive Federal Interest in the Interstate Gas Market.

When the Natural Gas Act was enacted in 1938, Congress intended to occupy the field of wholesale sales and transportation of natural gas in interstate commerce. *Exxon Corp.* v. *Eagerton*, 462 U.S. at 184; *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954). This legislation was intended to completely fill the regulatory gap between traditional state regulation of the production and gathering of interstate natural gas and the direct sale of this gas to end-users. *See FPC* v. *East Ohio Gas Co.*, 338 U.S. 464 (1950).

A state's jurisdiction over "production and gathering" has traditionally been limited to the actual act of producing the minerals, as well as the facilities necessary to collect those minerals. *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. at 677-78.[33] In *Interstate Natural Gas Co.* v. *FPC*, 331 U.S. 682 (1947), the contention that wellhead sales was part of the local gathering process was firmly rejected:

> By the time the sales are consummated, nothing further in the gathering process remains to be done. We have held that these sales are in interstate commerce. It cannot be doubted that their regulation is predominately a matter of national, as contrasted to local concern. All the gas sold in these transactions is destined

---

[33] *See Champlin Refining Co.* v. *Corporation Commission*, 286 U.S. 210 (1932), where, in upholding the state's power to regulate and allocate production among wells, the Court stated:

> It is clear that the regulations prescribed and authorized by the Act and the proration established by the commission apply only to production and not to sales or transportation of crude oil or its products. Such production is essentially a mining operation and therefore is not a part of interstate commerce even though the product obtained is intended to be and in fact is immediately shipped in such commerce.

Id. at 235.

> for consumption in states other than Louisiana. Unreasonable charges exacted at this stage of the interstate movement become perpetuated in large part as fixed items of cost which must be covered by rates charged subsequent purchasers of the gas, including the ultimate consumer. It was to avoid such situations that the Natural Gas Act was passed.

Id. at 692-3.

Northern Natural Gas Corp. v. *State Corporation Commission*, 372 U.S. 84 (1963) (hereinafter *Northern Natural*) clearly banned state ratable take regulations. The Court held that wellhead purchases by an interstate pipeline are within the federal dominion and regulatory scheme and cannot be regulated by the states. This holding was not based on the premise that a direct conflict existed between the Kansas ratable take order and some Commission regulations on the particular wellhead sales.[34] *Northern Natural* was instead based on the practical reality that any controls placed on the purchase of gas by an interstate pipeline are inextricably linked with the access to and ultimate cost of gas for the interstate consumer:

> [A]ny readjustment of purchasing patterns which such orders might require of purchasers who previously took unratably could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States. This relationship is a matter with respect to which Congress has given the Federal Power Commission paramount and exclusive authority. . . . The prospect of interference with the federal regulatory power in this area is made even more acute

---

[34] In *Northern Natural*, all of the gas produced was under contract and all had been certificated by the Federal Power Commission into interstate commerce. Wellhead price was not at issue. The real issue was that, by requiring ratable purchases, Kansas was creating take-or-pay claims which then had to be addressed by FERC in pipeline rate proceedings. *See* 372 U.S. at 86-7, 372 U.S. at 98 (Harlan, J., dissenting).

> by the fact that criminal sanctions imposed by state statute for noncompliance fall upon such purchasers and not upon local producers.

Id. at 92 (citations deleted).

The respondents in this case have conceded that, but for the NGPA, Mississippi's action would be preempted. It is, we submit, now incumbent upon them to show (1) that Congress intended to remove wellhead purchases by an interstate pipeline from the long-standing national concern and regulatory scheme and (2) that Congress intended to allow states to begin to regulate terms and conditions of those purchases. The answer to both questions is resoundingly "*No*" when one looks at the complete scope of the NGPA and its legislative history.

The NGPA was designed, in part, to alter the NGA's regulatory scheme over wellhead sales because that scheme had proven unresponsive to market changes. If Congress had just wanted to get out of the business of regulating wellhead sales, it would have done just that.[35] Instead, Congress created a complex new scheme for these "first sales" to complement continued regulation of interstate pipelines under the NGA. In *Public Service Commission* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 331 (1983), the Court stated:

> The NGPA is designed to preserve the Commission's authority under the NGA to regulate natural gas sales from pipelines to their customers; however, it is designed to supplant the Commission's authority to establish rates for the wholesale market, the market consisting of so-called "first sales" of natural gas.

---

[35] On at least five occasions in the past, legislation designed to exempt independent producers and their wellhead sales from federal jurisdiction has failed to pass. *See* H.R. 4051, 80th Congress, 1st Sess. (1947); H.R. 4099, 80th Congress, 1st Sess. (1947); H.R. 1758, 81st Congress, 1st Sess. (1949); and S. 1498, 81st Congress, 1st Sess. (1949); H.R. 6645, 84th Cong., 2d Sess. (1956); *see also*, Senator Aborezk's "History of Regulation of Natural Gas," 124 Cong. Rec. 30028 (1978).

The fact that this new federal scheme was intended to change or even reduce the previous regulatory burdens on wellhead sales and on producers does not make it any less pervasive or preemptive. It is clear that the utility-type regulation of wellhead sales to interstate pipelines under the Natural Gas Act was replaced with other "mechanisms" which, when combined with market supply/demand forces, were just as much of a "regulation' of those transactions as the ineffective ones being replaced.[36]

The legislative history of the NGPA makes it clear that Congress intended to expand federal dominion and control over natural gas. Far and away the most common cry among those Congressmen opposing the NGPA was its encroachment into traditional state regulatory areas and the additional regulatory maze which would be cast over the industry.[37]

The managers of the conference report, as well as others supporting the bill, argued that the extension of federal regulation into the intrastate market was necessary to combat the dual market which had significantly inhibited the interstate flow of gas supplies to non-producing states.[38] They also urged that the "first sales" scheme created

---

[36] *See* pages 8-10 and 12-13, *supra*.

[37] 124 Cong. Rec. 28661 (1978) (Statement of Sen. John Tower). Sen. Henry Bellmon of Oklahoma also voiced strong opposition "to this extension of federal regulation." 124 Cong. Rec. 29101 (1978). Sen. Robert Dole of Kansas was opposed to the "extension of federal control to an unregulated and free market" and "more regulation to the producer." 124 Cong. Rec. 30021 (1978). Sen. Howard Baker of Tennessee opposed the bill because it "would increase the amount of regulation that exists in the industry by extending the regulatory powers of the federal government to the intrastate market." 124 Cong. Rec. 29116 (1978).

[38] The constitutionality of this extension of federal jurisdiction is no longer in doubt. *Oklahoma* v. *FERC*, 494 F. Supp. 636 (W.D.Okla. 1980), *aff'd*, 661 F.2d 832 (10th Cir. 1981), *cert. denied*, 457 U.S. 1105 (1982).

under the NGPA would reduce the federal regulatory burdens on producers and, combined with the higher incentive prices, operate to spur an increase in drilling and production.[39]

Rep. John Dingell specifically addressed the fears of opponents that the NGPA would allow FERC to move into the traditional jurisdiction of states over drilling and production:

> The legislation does not contemplate that FERC will intrude into the traditional conservation functions performed by the states. This is a matter reserved to the state agencies who, in the exercise of their historical powers, will continue to regulate such matters as drillings, locations, completion techniques, production rates, etc. Of course, the Secretary of Energy is authorized under Section 505 to intervene as a matter of right in state prorationing proceedings. This intervention authority, however, does not grant the Secretary any substantive powers or displace any state authority.

124 Cong. Rec. 38366 (1978). Nowhere in the legislative history of this bill is there any discussion of retracting federal interest in the interstate gas market or relinquishing control to the states. *See, e.g.*, Findings and Purposes, S. Rep. No. 95-436, 95th Cong., 1st Sess. 2-4 (1977); Findings and Statement of Purposes, H.R. Rep. No. 95-543, 95th Cong. 1st Sess. 9-13, 136-39 (1977).

The NGPA does grant to the states limited authority over wellhead sales in two specific instances. First, it gives the states the right to make initial determinations as to which Title I pricing categories production from their

---

[39] *See* Comments of Sen. Henry M. Jackson, 124 Cong. Rec. 29108 (1978).

wells would be eligible for, subject to FERC guidelines and review.[40] Second, it gives states the right to prescribe lower maximum lawful ceiling prices for gas sold *intrastate*.[41] However, nowhere in the NGPA or in its legislative history is there any indication that Congress intended the states to have authority or control over first sales so different and more intrusive than that granted to them under Section 503(c) and 602(a).[42] *See, Exxon Corp.* v. *Eagerton*, 462 U.S. at 186.

Nowhere in the NGPA Conference Report or its legislative history is there any indication that Congress granted to the states any jurisdiction over any aspect of an interstate pipeline's operations. Nowhere is there any indication that Congress, well aware of this Court's past interpretations of NGA jurisdiction, intended to legislatively overrule or limit *Northern Natural*.[43] Given the efforts of Congress over the eighteen months preceding the enactment of the NGPA, and given the comprehensiveness of the bill itself, it must be concluded that Congress would have expressed an intention to allow states to enter this field if it had so intended. *See, e.g., Public Service Commission* v. *Mid-Louisiana Gas Co.*, 463 U.S. at 336.

---

[40] Section 503(c), 15 U.S.C. § 3413(c).

[41] Section 602(a), 15 U.S.C. § 3432(a); *Energy Reserves Group, Inc.* v. *Kansas Power and Light Co.*, 459 U.S. 400, 406-07 (1983).

[42] The Mississippi Supreme Court agrees that the Board's ratable take order was not a determination of maximum lawful ceiling prices. J. S. App. A at 51a.

[43] For example, the conference report made it clear that it was prospectively limiting *California* v. *Southland Royalty Co.*, 436 U.S. 519 (1978) and did not intend to prejudice the outcome in *Shell Oil Co.* v. *FERC*, 566 F.2d 536 (5th Cir. 1978), *aff'd*, 440 U.S. 1273 (1979), then pending before this Court. S. Rep. 1126, 95th Congress, 2nd Sess. 71, 111 (1978).

B. Mississippi's Ratable Purchase Requirement is an Obstacle to the Accomplishment of Congressional Objectives Underlying the Natural Gas Act and NGPA.

Mississippi's order requires Transco to *purchase* natural gas that has no value to Transco.[44] This gas has no value because it displaces gas which Transco had contractually committed to take and because the reserves owned by non-contract sellers are not committed to the future needs of Transco and its customers.

Further, Mississippi requires that Transco purchase that gas at a "reasonable" price.[45] Thus, under present market conditions, whatever Transco is forced to pay for this gas increases Transco's actual acquisition costs. Furthermore, by asserting jurisdiction only over the higher priced categories of gas, Mississippi's rule directly affects the quantities or mix of the various categories of gas which Transco purchases with a resulting cost increase.

State laws with even less impact on interstate pipelines' costs were condemned in both *Maryland* v. *Louisiana*, 451 U.S. 724 (1981) and *Exxon Corp.* v. *Eagerton*, 462 U.S. 176 (1983). In *Maryland* v. *Louisiana*, Louisiana tried to statutorily impose its First Use Tax on interstate pipelines. The First Use Tax was enacted in 1978 on gas produced in federal waters offshore Louisiana then transported through Louisiana. This Court held that the NGA, as amended by the NGPA, preempted such a charge by the states:

> Under the Gas Act, determining pipeline and producer costs is the task of the FERC in the first instance, subject to the judicial review. . . . Even if the FERC

---

[44] The Mississippi Supreme Court was well aware that this was the case. J. S. App. A at 45a-46a.

[45] The Mississippi Supreme Court's in essence means that the Board has the power to ensure that a pipeline's offer is reasonable, "determined by reference to prevailing market conditions and other economic considerations." J. S. App. A at 55a.

> ultimately determined that such expenses should be passed on *in toto*, this kind of decisionmaking is within the jurisdiction of the FERC; and the Louisiana statute, like the state Commission's order in *Northern Natural Gas, supra*, is inconsistent with the federal scheme and must give way. At the very least, there is an "imminent possibility of collision," *ibid.* The FERC need not adjust its rulings to accommodate the Louisiana statute. To the contrary, the state may not trespass on the authority of the federal agency.

451 U.S. at 751. The practical effect of Mississippi's ratable take order is identical to the Louisiana First Use Tax. Both create a state-ordered payment by an interstate pipeline which directly conflicts with FERC's authority to determine what costs should and will be passed to the ultimate consumer.

In *Exxon* v. *Eagerton*, this Court condemned Alabama's attempt to prohibit *producers* from passing through a statutory increase in the state severance tax on natural gas, to the extent that the increased tax applied to natural gas sold in interstate commerce. The Court stated:

> The Alabama pass-through prohibition trespassed on FERC's authority over wholesale sales of gas in interstate commerce, for it barred gas producers from increasing their prices to pass on a particular expense—the increase in severance tax—to their purchasers. Whether or not producers should be permitted to recover this expense from their purchasers is a matter within the sphere of FERC's regulatory authority. . . .

462 U.S. at 185.

Mississippi's ratable take order also conflicts with the intent of the NGPA that wellhead sales be governed by statutory maximum lawful ceiling prices and private contracts between producrs and purchasers. As stated in the Conference Report:

> The rule for application of ceiling prices pertains to maximum lawful prices. All maximum lawful prices

> are ceiling prices only. In no case may a seller receive a higher price than his contract permits.

H.R. Conf. Rep. No. 95-1752, 95th Cong., 2nd Sess. 74 (1978).

The fact that the NGPA first eliminated the statutory maximum lawful ceiling prices on "high cost" natural gas was the result of a Congressional determination that this classification needed "the maximum price incentive" in order to elicit "the maximum supply response at a minimum cost to consumers."[46] As the Mississippi Supreme Court itself observed:

> [A] federal decision to forego regulation in a given area may imply an authoritative federal determination that the area is best left *un*regulated, and in that event would have as much preemptive force as a decision *to* regulate.

J.S. App. A at 28a, *citing, Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission,* 461 U.S. 375, 384 (1983). Congress left no room in its regulatory scheme for state-imposed purchases which would increase the cost of service of interstate pipelines to their customers, in direct conflict with the market clearing constraints designed into the NGPA.[47]

Mississippi's idea that states can now regulate "deregulated" gas is further inimical to a primary purpose of Congress in enacting the NGPA—to eliminate the bifurcated natural gas markets. Congress made it absolutely clear that it was expanding federal controls over *all* natural gas in order to achieve a uniform national energy policy and to eliminate the ability of producing states and pro-

---

[46] This was the explanation given to the Senate by the floor manager for the NGPA, Sen. Henry M. Jackson, during the debates on the bill. 124 Cong. Rec. 28633 (1978).

[47] *See* Rep. Dingell's remarks at page 9, *supra*, concerning the intended effect of incremental pricing on a pipeline's purchases.

ducers to withhold supplies of gas from the rest of the nation. However, if interstate pipelines are now subjected to the "kaleidoscopic variations" [48] of state regulation over their purchases only in "deregulated" gas pools, the imminent possibility exists that states would use this power in a gas shortage to create the same market access problems the NGPA was designed to cure. As stated in *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 633-5 (1972):

> [A] state agency empowered to regulate these contracts would be obliged to regulate in the State not the national interest. . . . The unavoidable conflict between producing States and consuming States will create contradictory regulations that cannot possibly be equitably resolved by the courts. With these problems in mind, the desirability of uniform federal regulation is abundantly clear.

C. The Direct Conflict with Ongoing FERC Regulation of Interstate Pipelines.

The "imminent possibility of collision" in this case is no longer just imminent; it is a reality.

First, Mississippi's order has already been specifically raised as being in possible conflict with the "just and reasonable" standards of the NGA in Transco's latest tariff filing before FERC.[49] The FERC simply should not be required to adjust its rulings to accommodate a Mississippi regulation. *Maryland* v. *Louisiana*, 451 U.S. at 751.

Secondly, FERC has specifically opened an inquiry on possible discrimination of interstate pipelines in their purchasing practices.[50] The fact that FERC has not issued

---

[48] Compare Mississippi's approach to that proposed by Texas. *See* J. S. App. I at 136a.

[49] *See* Brief Amicus Curiae of Associated Gas Distributors in Support of Appellant's Jurisdictional Statement, 11-13 (February 1, 1985).

[50] *See* pages 15-16, *supra*.

specific orders or regulations in this matter does not make its active assertion of jurisdiction any less preemptive. *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission,* 461 U.S. at 384.

Finally, FERC is in the process of evaluating every facet of interstate pipelines' transportation and rate structure with the goal of enhancing pipelines' flexibility and competitiveness in the energy market.[51] Mandatory *purchase* by a pipeline from all producers in a particular pool or field, even at "reasonable" prices, is in conflict with FERC's encouragement of pipelines to transport more of other owners' gas.[52] Mandating the purchase of gas from all producers in a particular pool or field by a pipeline would significantly impair the broad jurisdiction which Congress gave FERC over interstate transportation of gas. NGA Sections 1(b) and 7(c), 15 U.S.C. §§ 717(b) and 717f (c). *FPC* v. *Louisiana Power & Light Co.,* 406 U.S. at 640-42; *United Gas Pipe Line Co.* v. *FPC,* 385 U.S. 83 (1966). FERC's jurisdiction must remain free of state interference in todays' complex and competitive gas market.

II.

Mississippi's Enforcement of Rule 48 Against an Interstate Pipeline Impermissibly Burdens and Discriminates Against Interstate Commerce.

The Commerce Clause of the Constitution, U.S. Const., art. I, § 8, cl. 3, specifically grants to Congress the power to regulate commerce among the states. Concomitantly, it also precludes burdensome or discriminatory state laws in

---

[51] 50 Fed. Reg. 114, 3801 (1985).

[52] If a pipeline transports gas, for a reasonable fee, on behalf of a producer or end user, it incurs no additional acquisition costs. The transportation fees, in effect, subsidize cost of service that normally would be paid by its resale customers. *See,* 18 C.F.R. Parts 157 and 284.

this protected sphere, even in the absence of Congressional action. *Missouri* v. *Kansas Natural Gas Co.*, 265 U.S. 298, 307 (1924).

The reasons supporting this negative Commerce Clause are aptly stated in *H. P. Hood & Sons, Inc.* v. *Dumond*, 336 U.S. 525, 537-38 (1949):

> This principle that our economic unit is the Nation, which alone has the gamut of powers necessary to control of the economy, including the vital power of erecting customs barriers against foreign competition, has as its corollary that the states are not separable economic units. As the Court stated in *Baldwin* v. *Seelig*, 294 U.S. 511, 527 "what is ultimate is the principle that one state in its dealings with another may not place itself in a position of economic isolation."

Mississippi has attempted to place itself in just such a position of economic isolation by its enforcement of Rule 48 against an interstate pipeline. Although the Board recognized the existence of a nationwide glut in the natural gas industry, it expressly refused to consider the exacerbating effect of its action on the problem. J.A. 159, 165, 169. Instead, it took action calculated to secure a market for Mississippi producers of natural gas without contracts. the practical effect of its decision is to discriminate against other producing states and to burden the consuming states, all in violation of the Commerce Clause.

A. The Applicable Test Under the Commerce Clause.

It has been clear for many years that the purchase and transportation of natural gas for resale by interstate pipeline companies is interstate commerce and subject to scrutiny under the Commerce Clause. In *Pennsylvania* v. *West Virginia*, 262 U.S. 553 (1923), the Court stated:

> Natural gas is a lawful article of commerce, and its transmission from one state to another for sale and

> consumption in the latter is interstate commerce. A state law, whether of the state where the gas is produced or that where it is to be sold, which by its necessary operation prevents, obstructs, or burdens such transmission, is a regulation of interstate commerce—a prohibited interference.

Id. at 596-97. *Accord, FPC* v. *Corporation Commission*, 362 F. Supp. 522 (W.D. Okla. 1973), *aff'd.* 415 U.S. 961 (1974).

Many of this Court's recent Commerce Clause cases recite a test enunciated in *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970) (hereinafter *Pike*), wherein the Court stated:

> Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. . . . If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact of interstate activities.

Id. at 142.

The first consideration is whether the state enactment in question discriminates against interstate commerce, either on its face or in practical effect. *Hughes* v. *Oklahoma*, 441 U.S. 322, 336 (1979). When such discrimination is used for economic protectionism, the statute is virtually *"per se"* unconstitutional. *Philadelphia* v. *New Jersey*, 437 U.S. 617, 624 (1978). *Accord, Bacchus Imports, Ltd.* v. *Dias*, 104 S.Ct. 3049 (1984) (stricter Commerce Clause scrutiny when there is discriminatory purpose or discriminatory effect).

On the other hand, if the effects of the questioned statute fall equally on both intrastate and interstate commerce, then the test requires a balancing of the local benefits

against the interstate burdens imposed. Also considered in this equation is the question of whether the state could have achieved its purposes with a less onerous impact on interstate commerce.[53] *Hughes* v. *Oklahoma*, 441 U.S. 322, 336 (1979).

In applying the Commerce Clause, this Court has consistently held that one cannot examine the challenged state regulation in a vacuum but must analyze its impact as it operates in the relevant industry—its "practical effect." *Id.* For example, in *Pennsylvania* v. *West Virginia* the Court looked at the "necessary operation" of the statute to determine whether it discriminated against or burdened interstate commerce. 262 U.S. at 597-98. The Court therein examined not only the provisions of the West Virginia act in question but also "the conditions which must surround its operation."[54] *Id.* at 597. In *Lewis* v. *B. T. Investment Managers, Inc.*, 447 U.S. 27, 37 (1980) the Court stated: "The principal focus of inquiry must be the practical operation of the statute, since the validity of state laws must be judged chiefly in terms of their probable effects." *Accord, Best & Co.* v. *Maxwell*, 311 U.S. 454, 455-56 (1940). Thus, in examining the law in question, consideration must also be given to the practical circumstances under which the law may operate to create an impermissible burden on interstate commerce.

Although the applicable Commerce Clause test has been stated in various ways, this Court, in *Hughes* v. *Alexander*

---

[53] The Mississippi Supreme Court ignored this requirement of the *Pike* test, finding instead that alternatives need not be considered until an "unreasonable burden on commerce" has been demonstrated.. J. S. App. A. at 38a.

[54] The Court has rejected burdens occasioned only by the fact that certain parties had chosen to package and market goods in a certain manner, *Hunt* v. *Washington Apple Advertising Comm'n*, 432 U.S. 333, 340 (1977), or to set up business operations in one state as opposed to another. *Pike*, 397 U.S. at 145.

Scrap Corp., 426 U.S. 794, 806 (1976), summarized the approaches as follows: "The common thread of all these cases is that the State interfered with the natural functioning of the interstate market either through prohibition or through burdensome regulation." As will be demonstrated, Mississippi has inferfered with the natural functioning of the market.

B. The "Practical Effect" of Mississippi's Ratable Take Order.

The facts as to the gas market facing Transco in 1982 have already been discussed in some detail. *See* J.S. at 15-19. Two conclusions from that discussion are relevant here. First, the total current interstate demand for gas is considerably less than pipeline purchase obligations. Transco and most other interstate pipelines therefore simply have no market for non-contract gas they may be forced to purchase in Mississippi. State-required purchases by Transco of non-contract gas in Mississippi will only displace contract gas and create additional take-or-pay claims.

Second, the crisis in the market is the product of many years of unsuccessful federal regulation and pipeline acquisition policies required and encouraged by such regulation. Transco's purchase contracts are a by-product of that environment and are not unique. Gas purchase contracts executed between 1978 and 1982 by nearly all interstate pipeline companies are long term contracts which contain seller-oriented price provisions with "one-way" escalators and high percentage take-or-pay provisions.[55]

---

[55] In the instant case, some of Transco's 1978-80 vintage contracts have "take-or-pay" clauses requiring takes of between 85-100% of contract deliverability. J.A. 103-04.

Take-or-pay costs in all pipelines' rates were over $700,000,000 in 1982. Since that time, such costs, which are borne by consumers have increased substantially. Energy Information Administration, U.S. Dept. of Energy,

Pierce, *Natural Gas Regulation, Deregulation & Contracts*, 68 Va. L. Rev. 63, 77, 92-99 & 103 (1982).

In light of the above, for Transco (or any pipeline) to take "ratably," it must reduce its contract purchases in order to accommodate increased non-contract takes from Mississippi. This reduction in contract purchases results in increased take-or-pay claims under those contracts.[56] Because Mississippi refuses to consider market demand in its regulation of production, Transco is forced to begin purchasing gas from Mississippi non-contract producers at a level which would be ratable with its Mississippi contract purchases. Because of high take-or-pay contracts, the practical result will be a significant increase in Mississippi purchases with a significant decrease in Transco's purchases from other states. This results not only in discrimination in the amount of gas taken from other states. Reductions in purchases from other states also increase take-or-pay claims there.

While it may be possible for Transco to purchase modest quantities of deregulated non-contract gas and reduce just its contract purchases in Mississippi to ratable levels, this course would still expose Transco to significant additional take-or-pay claims for gas under contract that is not taken thereby increasing its cost of service.[57]

Structure and Trends in Natural Gas Wellhead Contracts 38 (1983). By December of 1983, take-or-pay prepayment balances totalled approximately one billion dollars. Energy Information Administration, U.S. Dept. of Energy, *Statistics of Interstate Natural Gas Pipeline Companies*, Table 20 (1983).

[56] These are the same options faced by Northern Natural in 1963 when confronted with the Kansas ratable take order. *Northern Natural*, 372 U.S. at 98-99, n. 1 (Harlan, J., dissenting).

[57] Theoretically, Transco could terminate all purchases in Mississippi. This is not a practical alternative and is not one which a state can validly offer to the interstate pipeline in order to avoid constitutional infirmity.

No matter what course is taken, there will be a net increase in total purchases of deregulated gas with a resulting decrease in takes of regulated reserves. Because the cost of regulated gas is generally less than the price of deregulated gas, such a state-created shift in purchasing patterns likelise results in increased pipeline costs which must then be passed on to the consumer.

C. Increases In Total Pipeline Takes from Mississippi Caused by Rule 48 Operate as a Prohibited Discrimination Against Interstate Commerce.

The inevitable result of an enforceable Rule 48, when combined with Mississippi's refusal to regulate production on anything but maximum deliverability,[58] will be some increase in the percentage of gas taken from the state of Mississippi by Transco. This must necessarily result in a decrease in pipeline purchases from other producing states. In the present market situation, Mississippi's action discriminates against other states by securing a larger share of a limited market for its producers.

The Supreme Court has struck down discriminatory state regulations on many occasions. Early in the history of the natural gas industry, concern about the continuing availability of adequate supplies of natural gas prompted several states to prohibit its export, thereby reserving this valuable resource for their own citizens. In both *Pennsylvania* v. *West Virginia* and *West* v. *Kansas Natural Gas*, 221 U.S. 229 (1911), such regulations were invalidated because they discriminated against the interstate consumer by attempting to isolate the state from a problem common to all. *Accord, Tenneco, Inc.* v. *Sutton*, 530 F. Supp. 411 (M.D. La. 1981). In other contexts, state laws have been

---

Regulations which cause a company to cease doing business in a state are even more discriminatory than those discussed hereinbelow.

[58] *See*, Miss. Code Ann. § 53-1-1 (1972); J.A. at 92-95.

struck down because they likewise attempted to keep state-produced products within the state. *See, e.g., Sporhase* v. *Nebraska,* 458 U.S. 941 (1982); *Hughes* v. *Oklahoma,* 441 U.S. 322 (1979).

The scope of the Commerce Clause also extends to state laws which achieve economic isolation by discriminating against out-of-state competition. For example, in *Bacchus Imports, Ltd.* v. *Dias,* 104 S.Ct. 3049 (1984), Hawaii regulations which sought to encourage in-state liquor production were held unconstitutional because they also discriminated against out-of-state producers. Likewise, in *Hunt* v. *Washington Apple Advertising Commission,* 432 U.S. at 350, a North Carolina statute which effectively discouraged competition by Washington apple producers was overturned.

The practical effect of the Rule 48, to the extent that it increases purchases from Mississippi is to alter its market share at the expense of other producing states. Therefore, the Board's application of its Rule 48 on interstate pipelines interferes with the natural functioning of the national gas market and insulates Mississippi producers from difficult market conditions common to all-impermissible discrimination against interstate commerce. This Court described such a situation in *Exxon Corp.* v. *Governor of Maryland,* 437 U.S. 117, 126 n. 16 (1978):

> If the effect of a state regulation is to constitute a larger share, and goods with an out-of-state source to constitute a smaller share of the total sales in the market—as in *Hunt,* 432 U.S. at 347, and *Dean Milk,* 340 U.S. at 354—the regulation may have a discriminatory effect on interstate commerce.

In this case, the Board expressed no actual intent to discriminate against other producing states. However, this Court has never allowed the state's characterization of its purpose to be determinative. *Foster-Fountain Packing Co.* v. *Haydel,* 278 U.S. 1, 10 (1928). In numerous instances, the

Board refused to admit evidence proffered by Transco on the interstate impact of the enforcement of Rule 48. The Board steadfastly declined to consider such impact, even in light of its admitted knowledge of the national market glut. J.A. 158. Instead, the Board devoted its attention only to the question of whether or not Transco was taking ratably in Mississippi. J.A. 155-58, 163-69.

The Mississippi Supreme Court based its upholding of Rule 48 on the local interest in "fairness." J.S. App. A at 34-5a. However, it is clear Mississippi's regulation operates unfairly to producers in other states who sell to Transco or other pipelines operating in Mississippi.[59] Its effect, either intentional or unintentional, is to protect Mississippi natural gas producers by forcing Mississippi production onto the interstate market at the expense of production from other producing states.[60] Rule 48 discriminates against interstate commerce and is therefore unconstitutional.

---

[59] In keeping gas well allowable production at maximum deliverability, without regard to the market, Mississippi provides impetus for its producers to file substantial take-or-pay claims. This fact, in and of itself, creates a burden on the interstate market not present in states which establish allowables based on market demand.

[60] The Mississippi Supreme Court dismissed Transco's prediction that increased purchases from Mississippi would result in decreased purchases elsewhere. The Court's principal response was to note that other states have ratable take statutes. J.S. App. A, at 36. However, this response is not correct. As noted above, Mississippi's regulations force excessive quantities of Mississippi gas onto the market. *See, e.g., Northern Natural Gas* v. *State Corp. Comm'n*, 372 U.S. at 86-9. Widespread enforcement of such regulations will unfortunately lead to direct state-on-state competition for larger shares of a very limited market. This is the very evil sought to be corrected by the Commerce Clause. *See Pennsylvania* v. *West Virginia*, 262 U.S. at 599.

D. The Impact of Rule 48 On the Cost of Gas in the Interstate Market Constitutes an Impermissible Burden.

Even if Transco could achieve ratable taking by only decreasing its Mississippi contract purchases of gas, the resulting increase in take-or-pay claims would still substantially increase its cost of service. Additionally, Mississippi's application of its ratable take authority only over price-deregulated gas results in greater purchases of deregulated reserves at the expense of regulated reserves. This directly increases the total cost of gas purchased. Both of these impacts result in increases in the price of natural gas to the interstate consumer.

This Court has long observed that such price increases can constitute impermissible burdens on interstate commerce. In *Southern Pacific Co.* v. *Arizona,* 325 U.S. 761 (1945), the Court examined a state regulation which limited the length of trains below what was the standard practice in the industry. To break up and reassemble interstate trains at the Arizona line was found to be both expensive and inefficient. *Id.* at 772. Therefore, the Court found that the law impermissibly burdened interstate commerce.

Likewise, in *Hunt* v. *Washington Apple Advertising Commission,* 432 U.S. 333 (1977), Washington producers of apples challenged a North Carolina statute which prohibited the use of Washington's apple grading system. Although the Washington system was superior to the USDA grading system, only the latter was allowed to appear on cartons shipped into North Carolina. Washington growers could not comply with the statute without repackaging the apples or otherwise changing their usual practices—options which were characterized as "costly and less efficient." 432 U.S. at 338. The Supreme Court struck down

the statute, finding both a burden on and discrimination against interstate commerce. *Id.* at 350.

In both *Kassell* v. *Consolidated Freightways Corp.*, 450 U.S. 662, 674 (1981), and *Raymond Motor Transportation, Inc.* v. *Rice*, 434 U.S. 429, 445 (1978), the Court struck down state laws which precluded the use of double-trailer trucks on state highways. In each case, the Court reasoned that the expense and delay which accrued by shippers having to either route their trucks around the offending states or repack their shipments placed a substantial, and unconstitutional, burden on interstate commerce.

In the area of natural gas regulation, interstate price burdens have long been the subject of judicial scrutiny. In 1950, the wellhead price of gas was relatively insignificant compared to interstate transmission costs. Therefore, state orders imposing a price burden of only a few cents per Mcf were held not to violate the Commerce Clause. *Cities Service Gas Co.* v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950) (hereinafter *Peerless*).[61]

However, the gas market conditions which supported the *Peerless* decision have since changed dramatically. In *FPC* v. *Corporation Commission*, 362 F. Supp. 522 (W.D. Okla. 1973), *aff'd*, 415 U.S. 961 (1974), regulations setting a minimum price of only $.20 per Mcf were found to place an impermissible burden on interstate commerce. The court found that "*Peerless* no longer controls insofar as it holds that minimum price orders are not within the proscription

---

[61] In fact, the Oklahoma Commission had found that the then prevailing prices were so low as to cause waste, losses to interest owners, tax losses to the state and discrimination. 340 U.S. at 183. These facts are in direct contrast to today's market where excessively high gas prices have contributed to loss of markets.

of the Commerce Clause." *Id.* at 535. One basis for distinguishing *Peerless* was the difference in the minimum price orders and their impact on the ultimate consumer. The three judge panel stated:

> The Court said in *Peerless* that "the wellhead price of gas is but a fraction of the price paid by domestic consumers at the burner-tip, so that the field price as herein set may have little or no effect on the domestic delivered price." In *Phillips*, however, the Court declared that the "rates charged may have a direct and substantial effect on the price paid by the ultimate consumers."

Id.

In today's market, gas at the wellhead costs dollars, not cents. For example, in *Cities Service Gas Co.* v. *FERC*, 627 F.2d 1027, 1028 (10th Cir. 1980), it was observed that, "[t]he cost of purchased gas constitutes the largest single component of a pipeline company's cost of service and it is an expense of doing business which is recovered by the pipeline in the rates it charges to customers." By 1982, Transco's cost of gas was over 82% of the delivered price. *See* J.A. 226.

The Mississippi Court held that the price increases occasioned by Rule 48 constituted only an "incidental," and therefore acceptable, interstate burden. This determination rests upon the court's conclusion that price increases to the consumer were sanctioned by and a necessary part of the NGPA. J.S. App. A at 35a-36a.

However, this Court has frequently stated that, although Congress may authorize the states to burden interstate commerce, such authorization must be explicit. *South Central Timber Development, Inc.* v. *Wunnicke*, 104 S.Ct. 2237, 2240-41 (1984); *Sporhase* v. *Nebraska*, 458 U.S. 941, 960 (1982); *New England Power Co.* v. *New Hampshire*, 455 U.S. 331, 343 (1982). The only explicit delegation of

Commerce Clause power appears in Section 602(a) of the NGPA.[62] There, the states were given authority only to impose lower ceiling prices and only over "first sales" of gas in the *intrastate* market.[63] S. Conf. Rep. No. 1126, 95th Cong., 2d Sess. 124-5 (1978); H. R. Conf. Rep. No. 1752, 95th Cong., 2d Sess 124-5 (1978); *Exxon Corp.* v. *Eagerton*, 462 U.S. at 186.[64] Mississippi's reliance on the NGPA is therefore misplaced because Congress has never expressly given the states authority over transportation or sales of "deregulated gas" in interstate commerce. Congress withheld this power from producing states in order to protect a fundamental national concern, the cost of gas to consuming states.

E. Constitutional Regulatory Alternatives Do Exist

In *Pike*, the Court observed that facially nondiscriminatory regulations which do burden interstate commerce may not pass constitutional muster if less burdensome alternatives are available to achieve the state's purposes.

The sole basis given by the Mississippi Court for upholding Rule 48 is to assure fairness by preventing drainage which might be caused by contract producers selling

---

[62] As discussed above, page 11, *supra*, Section 503(c), 15 U.S.C. 3413(c) authorized state agency determination of price classifications, but subject to FERC control and review.

[63] Moreover, under the NGPA, prices are to be limited not only by ceilings but also by contracts *negotiated* between buyer and seller. See pages 31-32, *supra*.

[64] In *Energy Reserves Group, Inc.* v. *Kansas Power & Light Co.*, 459 U.S. 400, 407 (1983), Section 602(a) was found to give Kansas the power to impose price ceilings on the sale of intrastate gas. No Commerce Clause issue was raised because the case did not deal with interstate gas. *Id.* at 413, n. 17.

gas while non-contract producers in the same pool are unable to do so. J.S. App. A at 34-5a.

Mississippi has an alternative to achieve this purpose, one which the state has clearly and intentionally ignored. In *Champlin Refining Co.* v. *Corporation Commission*, 286 U.S. 210, 235 (1932), the Court approved Oklahoma's proration regulations which precluded any owner of gas from *producing* more than his pro rata share of "market demand."[65] A primary basis for the Court's approval was that proration dealt with the production of natural gas and therefore occurred prior to entry of that commodity into interstate commerce.[66] In *Northern Natural*, 372 U.S. at 94, n. 12, the Court again suggested proration as a proper and effective alternative to the state ratable take orders found unconstitutional therein.

There is nothing that stops Mississippi from taking a similar approach.[67] A state can limit a local producer's right to produce more than his pro rata share of the available market for a common pool and effectively negate a purchaser's contract obligations in excess of that limit.

---

[65] Oklahoma defined waste to include production in excess of market demand. 286 U.S. at 226. The State's action was prompted by serious potential overproduction, production which exceeded "all transportation and marketing facilities and market demands," *Id.* at 230, a situation not unlike today's gas market.

[66] See note 33, *supra*.

[67] The Mississippi Court discussed in detail the Board's broad powers, both express and implied, to protect Mississippi producers from drainage. J.S. App. A at 42a-48a. Additionally, the court cited *Barnwell, Inc.* v. *Sun Oil Co.*, 249 Miss. 398, 162 So.2d 635, 638 (1964), for the proposition that the "Board has power to allocate and apportion production." *Id.* at 45a. Although the Board has questioned its statutory authority under Miss. Code Ann. § 53-1-1 (1972) to consider market demand in setting well allowables, J.A. 93-95, the Mississippi legislature can certainly amend its law to eliminate any doubt.

See, Energy Reserves Group, Inc. v. *Kansas Power & Light Co.*, 459 U.S. 400 (1983). The available market can then be allocated to all owners without increasing the cost of service by interstate pipelines. Such action would eliminate any burden on interstate commerce while serving the states' interest in fairness.

Clearly, Mississippi has ignored a constitutional alternative to Rule 48 which does not impose a direct burden on interstate commerce. The Mississippi court further interpreted Rule 48 as requiring Transco to purchase at a "reasonable" price.[68] Since Rule 48 goes further than is necessary to achieve the state's purposes, and since there is an element of minimum price regulation, Mississippi has effectively sought to insulate its producers from a nationwide problem. Such economic protectionism should render the rule unconstitutional *per se*. *Philadelphia* v. *New Jersey*, 437 U.S. at 624. Alternatively, the fact that Mississippi's regulation intrudes so much further into interstate commerce than is necessary to achieve Mississippi's purpose indicates that the balancing required under *Pike* weighs heavily against the constitutionality of this regulation.

CONCLUSION

In its attempted enforcement of Rule 48, the Board acted in a somewhat predictable manner. The Board's principal function is the development and protection of oil and gas interests in the State of Mississippi. It is not charged with protecting consumers of natural gas, either within Mississippi or outside the state. Likewise, it is not charged by the Mississippi legislature with the obligation of regulating

---

[68] We have previously detailed how increased purchases of deregulated gas, even at market prices, displace purchases of low cost regulated gas, thereby increasing consumer prices.

in the national interest. The Board's narrow focus is precisely the type of local prejudice that the Commerce Clause and the Supremacy Clause were designed to prevent.

In *South-Central Timber Development, Inc.* v. *Wunnicke*, 104 S.Ct. 2237 (1984), the Court, in discussing the Commerce Clause, stated:

> Unrepresented interests will often bear the brunt of regulations imposed by one State having a significant effect on persons or operations in other States. Thus, "when the regulation is of such a character that its burden falls principally upon those without the state, legislative action is not likely to be subjected to those political restraints which are normally exerted on legislation where it affects adversely some interests within the state."

Id. at 2243. The Court went on to state:

> On the other hand, when Congress acts, all segments of the country are represented and there is significantly less danger that one State will be in a position to exploit others. Furthermore, if a state is in such a position, the decision to allow it is a collective one.

Id.

Mississippi's attempt to regulate without regard to the national interest is the perfect example of why Congress did not intend to allow states to enter a field from which they had been excluded since 1938. Even though Congress has eliminated the ceiling on wellhead pricing of certain categories of natural gas, all available evidence indicates that it never intended to allow any state regulation of those sales in interstate commerce, especially in the manner attempted by Mississippi.

For the foregoing reasons, the judgments below should be reversed.

Respectfully submitted,

JOHN MARSHALL GROWER
(Counsel of Record)
JEFFERSON D. STEWART
R. WILSON MONTJOY II
BRUNINI, GRANTHAM, GROWER & HEWES

R. V. LOFTIN, JR.
THOMAS E. SKAINS
DAVID A. GLENN
TRANSCONTINENTAL GAS PIPE LINE CORPORATION

Attorneys for Appellant

APPENDIX

APPENDIX A

RELEVANT EXCERPTS FROM THE NATURAL GAS ACT

Section 1, 15 U.S.C. 717:

(a) As disclosed in reports of the Federal Trade Commission made pursuant to S.Res. 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.

(b) The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

(c) The provisions of this chapter shall not apply to any person engaged in or legally authorized to engage in the transportation in interstate commerce or the sale in interstate commerce for resale, of natural gas received by such person from another person within or at the boundary of a State if all the natural gas so received is ultimately consumed within such State, or to any facilities used by such person for such transportation or sale, provided that the rates and service of such person and facilities be subject to regulation by a State commission. The matters exempted from the provisions of this chapter by this subsection are declared to be matters primarily of local concern and subject to regulation by the several States. A certification from such State commission to the Federal Power Commission

that such State commission has regulatory jurisdiction over rates and service of such person and facilities and is exercising such jurisdiction shall constitute conclusive evidence of such regulatory power or jurisdiction.

Section 4(b), 15 U.S.C. 717c(b):

No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

Section 5(a), 15 U.S.C. 717d(a):

Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order: *Provided, however,* That the Commission shall have no power to order any increase in any rate contained in the currently effective schedule of such natural gas company on file with the Commission, unless such increase is in accordance with a new schedule filed by such natural gas company; but the Commission may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates.

RELEVANT EXCERPTS FROM THE NATURAL GAS POLICY ACT OF 1978

Section 101(b)(9), 15 U.S.C. § 3311(b)(9):

Effect on contract price.—In the case of—

(A) any price which is established under any contract for the first sale of natural gas and which does not exceed the applicable maximum lawful price under this subchapter, or

(B) any price which is established under any contract for the first sale of natural gas which is exempted under part B of this subchapter from the application of a maximum lawful price under this subchapter,

such maximum lawful price, or such exemption from such a maximum lawful price, shall not supersede or nullify the effectiveness of the price established under such contract.

Section 107(c), 15 U.S.C. § 3317(c):

Definition of high-cost natural gas.—For purposes of this section, the term "high-cost natural gas" means natural gas determined in accordance with section 3413 of this title to be—

(1) produced from any well the surface drilling of which began on or after February 19, 1977, if such production is from a completion location which is located at a depth of more than 15,000 feet;

(2) produced from geopressured brine;

(3) occluded natural gas produced from coal seams;

(4) produced from Devonian shale; and

(5) produced under such other conditions as the Commission determines to present extraordinary risks or costs.

Section 121(a) and (b), 15 U.S.C. 3331(a) and (b):

Elimination of price controls for certain natural gas sales

(a) General rule.—Subject to the reimposition of price controls as provided in section 122[3332] of this title, the provisions of part A of this subchapter respecting the maximum lawful price for the first sale of each of the following categories of natural gas shall, except as provided in subsections (d) and (e) of this section, cease to apply effective January 1, 1985:

(1) New natural gas.—New natural gas (as defined in section 102(c)[3312(c)] of this title).

(2) New, onshore production wells.—Natural gas produced from any new, onshore production well (as defined in section 103(c)[3313(c)] of this title), if such natural gas—

(A) was not committed or dedicated to interstate commerce on April 20, 1977; and

(B) is produced from a completion location which is located at a depth of more than 5,000 feet.

(3) Intrastate contracts in excess of $1.00.—Natural gas sold under an existing contract, any successor to an existing contract, or any rollover contract, if—

(A) such natural gas was not committed or dedicated to interstate commerce on November 8, 1978; and

(B) the price paid for the last deliveries of such natural gas occurring on December 31, 1984, or, if no deliveries occurred on such date, the price would have been paid had deliveries occurred on such date is higher than $1.00 per million Btu's.

(b) High-cost natural gas.—Effective beginning on the effective date of the incremental pricing rule required un-

der section 201[3341] of this title, the provisions of part A of this subchapter respecting the maximum lawful price for the first sale of natural gas shall cease to apply to the first sale of high-cost natural gas which is described in section 107[3317](c)(1), (2), (3), or (4) of this title.

Section 122, 15 U.S.C. 3332:

Standby price control authority

(a) Reimposition of price controls.—The President, in accordance with subsection (c)(1) of this section, or the Congress, in accordance with subsection (c)(2) of this section, may reimpose maximum lawful prices for first sales of natural gas to which section 121[3331](a) of this title applies and delivery of which occurs after the effective date of the reimposition of such maximum lawful prices.

(b) Limitations.—A reimposition of maximum lawful prices under this section—

(1) may not take effect earlier than July 1, 1985, nor later than June 30, 1987; and

(2) shall remain in effect for a period of 18 months.

(c) Procedure for reimposing price controls.—For purposes of this section—

(1) Presidential reimposition.—Any exercise of authority by the President under subsection (a) of this section shall be by written order issued after May 31, 1985, and, subject to subsection (b) of this section, shall take effect for the first month beginning after the first 30 calendar days of continuous session of Congress (as determined in accordance with section 507 [3417](b) of this title) after a copy of such order has been submitted to each House of the Congress unless during such 30 calendar days of continuous session of Congress, the Congress adopts a concurrent resolution

of disapproval described in section 507[3417](c)(1) of this title.

(2) Congressional reimposition.—Any exercise of authority by the Congress under subsection (a) of this section shall be by the adoption of a concurrent resolution after May 31, 1985, described in section 507 [3417](c)(2) of this title and, subject to subsection (b) of this section, shall take effect for the first month beginning after the date of the adoption of such resolution.

(d) Maximum lawful prices applicable under reimposition of price control.—If maximum lawful prices are reimposed under this section on first sales of natural gas to which section 121[3331](a) of this title applies, the maximum lawful price under this section for any first sale of such natural gas delivered during any month shall be—

(1) except as provided in paragraph (2), the maximum lawful price, per million Btu's, computed for such month under section 102[3312] of this title (relating to new natural gas); and

(2) the maximum lawful price, per million Btu's, computed for such month under section 103[3313](b)(2) of this title (relating to new, onshore production wells 5,000 feet or less in depth), in the case of natural gas produced from any new, onshore production well (as defined in section 103[3313](c) of this title) if such natural gas—

(A) was not committed or dedicated to interstate commerce on April 20, 1977; and

(B) is produced from a completion location which is located at a depth of 5,000 feet or more.

(e) Allowance for State severance taxes and certain production-related costs.—A price may exceed the maximum lawful price applicable for such natural gas under this

section to the same extent as it provided under section 110[3320] of this title with respect to maximum lawful prices under part A of this subchapter.

(f) Limitation.—Maximum lawful prices may be reimposed only once under this section.

Section 315, 15 U.S.C. 3375:

Contract duration; right of first refusal; filing of contracts and agreements

(a) Contract duration.—

(1) General rule.—The Commission may, by rule or order, specify the minimum duration of any contract (other than any existing contract) for the purchase of natural gas to which section 601[3431](a)(1)(A) or (B) of this title is applicable. In no case may the minimum contract duration specified under this paragraph applicable to natural gas produced from any reservoir exceed 15 years or, if less, the commercially producible life of such reservoir. The provisions of this paragraph shall not apply to contracts of natural gas subject to the requirements of paragraph (3).

(2) Nondiscriminatory application.—

(A) In general.—Except as provided in subparagraph (B), the Commission may not exercise the authority provided under paragraph (1) in a manner which—

(i) provides an advantage to interstate pipelines by diverting supplies fo natural gas to interstate pipelines and thereby denying adequate supplies of natural gas to intrastate pipelines; or

(ii) otherwise discriminates between purchases by interstate pipelines and intrastate pipelines of natural gas.

(B) Special circumstances.—The Commission may vary any requirement established under paragraph (1) with respect to any contract by an interstate pipeline or intrastate pipeline to the extent necessary to respond to special circumstances.

(3) Contracts for purchase of OCS natural gas.—The Commission shall prescribe a rule which shall require that any first sale contract (other than any existing contract) for the purchase of natural gas which is produced from any reservoir on the Outer Continental Shelf and which is new natural gas (as defined in section 102[3312](b) of this title) or high-cost natural gas (as defined in section 107[3317](c)(1), (2), (3), or (4) of this title) shall be for a duration of not less than 15 years or, if less, the commercially producible life of the reservoir.

(b) Offers; right of first refusal.—

(1) Application.—This subsection shall apply with respect to any natural gas which is committed or dedicated to interstate commerce on November 8, 1978, and which is—

(A) high-cost natural gas (as defined in section 107[3317](c)(1), (2), (3), or (4) of this title);

(B) new natural gas (as defined in section 102 [3312](c) of this title); or

(C) natural gas produced from any new, onshore production well (as defined in section 103 [3313](c) of this title).

This subsection shall not apply to any natural gas committed or dedicated to interstate commerce solely by reason of section 2[3301](18)(A)(i) of this title.

(2) Offer of sale.—The Commission shall, by rule, require that if natural gas subject to the requirements

of this subsection is produced on or after the first day of the first month beginning after November 9, 1978, a bona fide offer to sell such natural gas must be made to the person who, but for the provisions of section 601 [3431](a)(1)(B) of this title (relating to deregulation), would have been entitled pursuant to the commitment or dedication of such natural gas to interstate commerce to receive such natural gas if such natural gas were sold (or any successor in interest to such person).

(3) Right of first refusal.—The Commission shall, by rule, require that following—

(A) the expiration or termination of any contract with respect to the first sale of natural gas subject to the requirements of this subsection to the person who, but for the provisions of section 601[3431](a)(1)(B) of this title (relating to deregulation), would have been entitled pursuant to the commitment or dedication of such natural gas to interstate commerce to receive such natural gas if such natural gas were sold (or any successor in interest to such person), or

(B) any rejection of any bona fide offer, described in paragraph (2), to sell natural gas subject to the requirements of this subsection,

such person who would have been entitled to receive such natural gas shall be granted a right of first refusal of the first offer to sell such natural gas which, subject to the exercise of any right of first refusal under this paragraph, has been substantially accepted in principle by another person in an arms-length transaction.

(c) Filing of contracts and ancillary agreements.—The Commission may, by rule or order, require any first sale purchaser of natural gas under a new contract, a successor

to an existing contract, or a rollover contract to file with the Commission a copy of such contract, together with all ancillary agreements and any existing contract applicable to such natural gas.

Section 501, 15 U.S.C. 3411:

General rulemaking authority

(a) In general.—Except where expressly provided otherwise, the Commission shall administer this chapter. The Commission, or any other Federal officer or agency in which any function under this chapter is vested or delegated, is authorized to perform any and all acts (including any appropriate enforcement activity), and to prescribe, amend, and rescind such rules and orders as it may find necessary or appropriate to carry out its functions under this chapter.

(b) Authority to define terms.—Except where otherwise expressly provided, the Commission is authorized to define, by rule, accounting, technical, and trade terms used in this chapter. Any such definition shall be consistent with the definitions set forth in this chapter.

(c) Delegation of certain determinations.—The Commission may delegate to any State agency (with the consent of such agency) any of its functions with respect to sections 105[3315], 106[3316](b), and 109[3319](a)(1) and (3) of this title.

Section 503(a)-(d), 15 U.S.C. 3413(a)-(d):

Determinations for qualifying under certain categories of natural gas

(a) General rule.—

(1) Determination.—If any State or Federal agency makes any final determination which it is authorized

to make under subsection (c) of this section for purposes of—

(A) applying the definition of new natural gas under section 102[3312](c) of this title;

(B) deciding if certain natural gas produced from the Outer Continental Shelf qualifies under section 102[3312](d) of this title for the new natural gas ceiling price;

(C) applying the definition of new, onshore production well under section 103[3313](c) of this title;

(D) applying the definition of high-cost natural gas under section 107[3317](c) of this title; or

(E) applying the definition of stripper well natural gas under section 108[3318](b) of this title;

such determination shall be applicable under this chapter for such purposes unless such determination is reversed under the provisions of subsection (b) of this section or unless such State or Federal agency has waived its authority under the provisions of subsection (c) of this section.

(2) Notice to Commission.—Any Federal or State agency making a determination under paragraph (1) shall provide timely notice in writing of such determination to the Commission. Such notice shall include such substantiation and be in such a manner as the Commission may, by rule, require.

(b) Commission review.—

(1) Authority to review and reverse.—The Commission shall reverse any final State or Federal agency determination described in subsection (a) of this section if—

(A) it makes a finding that such determination is not supported by substantial evidence in the record upon which such determination was made; and

(B) such preliminary finding and notice thereof under paragraph (3) is made within 45 days after the date on which the Commission received notice of such determination under subsection (a)(2) of this section and the final such finding is made within 120 days after the date of the preliminary finding.

(2) Remand on basis of Commission information.—If—

(A) the Commission finds that a State or Federal agency determination is not consistent with information contained in the public records of the Commission, and which is not part of the record upon which such determination was made; and

(B) such preliminary finding and notice thereof under paragraph (3) is made within 45 days after the date on which the Commission received notice of such determination under subsection (a) (2) of this section and the final such finding is made within 120 days after the date of the preliminary finding.

it may remand the matter to such State or Federal agency for consideration of such information. If such agency, after consideration of the information transmitted to it by the Commission, affirms its previous determination, such determination, as so affirmed, shall be subject to review in accordance with this subsection (other than this paragraph).

(3) Notice.—The Commission shall provide notice of any proposed finding under this subsection to the

State or Federal agency which made such determination and those parties identified in the notice to the Commission of such determination.

(4) Judicial review of Commission actions.—

(A) Remands.—Any party identified in the notice to the Commission of a determination by a State or Federal agency may obtain review of any final decision by the Commission to remand under paragraph (2) in the United States Court of Appeals for any circuit in which such party is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia circuit. The reviewing court shall reverse any such decision if it finds such decision is arbitrary or capricious.

(B) Findings.—Any person aggrieved or adversely affected by a final finding of the Commission under paragraph (1) may within 60 days thereafter file a petition for review of such finding in the United States Court of Appeals for any circuit in which the party involved in such determination is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia circuit. The reviewing court shall reverse any such finding of the Commission if the State or Federal agency determination involved is supported by substantial evidence.

(c) State authority.—

(1) General rule.—A Federal or State agency having regulatory jurisdiction with respect to the production of natural gas is authorized to make determinations referred to in subsection (a) of this section.

(2) Waiver.—

(A) In general.—Any Federal or State agency may, in whole or in part, waive its authority to make determinations referred to in subsection (a)(1) of this section by entering into an agreement in accordance with subparagraph (B). If such agency executes such a waiver, the Commission shall, consistent with the agreement, make the determinations which would otherwise be made by such Federal or State agency until the earlier of—

(i) the expiration of the period specified in the agreement; or

(ii) the date such agency transmits to the Commission written notice that it terminates such waiver and assumes the authority to make determinations referred to in subsection (a)(1) of this section.

Any waiver, or termination of any waiver, shall not apply to any determination with respect to any petition therefor which is pending before such agency or the Commission (as the case may be) on the date on which such a waiver or revocation is made.

(B) Agreements.—Any waiver under subparagraph (A) may be made only by a written agreement between the Federal or State agency involved and the Commission. Any such agreement shall set forth the terms and conditions applicable to such waiver.

(3) Procedures applicable.—Determinations of a Federal or State agency referred to in subsection (a)(1) of this section shall be made in accordance with the procedures generally applicable to such agency for the making of such determinations or comparable determinations under the provisions of Federal or State

law, as the case may be, pursuant to which they exercise their regulatory jurisdiction. The Commission may prescribe the form and content of filings with a Federal or State agency in connection with determinations made under this section.

(4) Judicial review.—Any such determination referred to in subsection (a)(1) of this section made in accordance with procedures described in paragraph (3) shall not be subject to judicial review under any Federal or State law except as provided under subsection (b) of this section.

(d) Effect of determination.—For purposes of this chapter.—

(1) General rule.—Any final determination referred to in subsection (a)(1) of this section made by a Federal or State agency (or by the Commission under subsection (c)(2) of this section) which relates to any natural gas and which is no longer subject to review by the Commission under this section or to judicial review shall thereafter be binding with respect to such natural gas. The preceding sentence shall not apply to any final determination—

(A) if in making such determination the Commission or such Federal or State agency relied on any untrue statement of a material fact; or

(B) if there was omitted a statement of material fact necessary in order to make the statements made not misleading, in light of the circumstances under which they were made, to the Federal or State agency in making such final determination or to the Commission in reviewing such determination.

(2) Application of title 18.—Any untrue statement or omission of material fact to a Federal or State agency upon which the Commission relied shall be

deemed to be a statement or entry under section 1001 of Title 18.

Section 505(a), 15 U.S.C. 3435(a):

(a) Authority to intervene.—

(1) Intervention as matter of right.—The Secretary of Energy may intervene as a matter of right in any proceeding relating to the prorationing of, or other limitations upon, natural gas production which is conducted by any State agency having regulatory jurisdiction over the production of natural gas.

(2) Enforcement of right to intervene.—The Secretary may bring an action in any appropriate court of the United States to enforce his right to intervene under paragraph (1).

(3) Access to information.—As an intervenor in a proceeding described in subsection (a) of this section, the Secretary shall have access to information available to other parties to the proceeding if such information is relevant to the issues to which his participation in such proceeding relates. Such information may be obtained through reasonable rules relating to discovery of information prescribed by the State agency.

Section 601, 15 U.S.C. 3431:

Coordination with Natural Gas Act

(a) Jurisdiction of Commission under Natural Gas Act.—

(1) Sales.—

(A) Natural gas not committed or dedicated.—For purposes of section 1(b) of the Natural Gas Act, effective on the first day of the first month beginning after November 9, 1978, the provisions

of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply to natural gas which was not committed or dedicated to interstate commerce as of November 8, 1978, solely by reason of any first sale of such natural gas.

(B) Committed or dedicated natural gas.—Effective beginning on the first day of the first month beginning after November 9, 1978, for purposes of section 1(b) of the Natural Gas Act, the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of November 8, 1978, and which is—

(i) high-cost natural gas (as defined in section 107[3317](c)(1), (2), (3), or (4) of this title);

(ii) new natural gas (as defined in section 102[3312](c) of this title); or

(iii) natural gas produced from any new, onshore production well (as defined in section 103 [3313](c) of this title).

(C) Authorized sales or assignments.—For purposes of section 1(b) of the Natural Gas Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply by reason of any sale of natural gas—

(i) authorized under section 302[3362](a) or 311[3371](b) of this title; or

(ii) pursuant to any assigned authorized under section 312[3372](a) of this title.

(D) Natural-gas company.—For purposes of the Natural Gas Act, the term "natural-gas company"

(as defined in section 2(6) of such Act) shall not include any person by reason of, or with respect to, any sale of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission do not apply to such sale solely by reason of subparagraph (A), (B), or (C) of this paragraph.

(E) Alaskan natural gas.—Subparagraph (B) (ii) and (iii) shall not apply with respect to natural gas produced from the Prudhoe Bay unit of Alaska and transported through the transportation system approved under the Alaska Natural Gas Transportation Act of 1976.

(2) Transportation.—

(A) Jurisdiction of the Commission.—For purposes of section 1[717](b) of the Natural Gas Act the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply to any transportation in interstate commerce of natural gas if such transportation is—

(i) pursuant to any order under section 302 [3362](c) or section 303[3363](b), (c), (d), or (h) of this title; or

(ii) authorized by the Commission under section 311[3371](a) of this title.

(B) Natural-gas company.—For purposes of the Natural Gas Act, the term "natural-gas company" (as defined in section 2[717a](6) of such Act) shall not include any person by reason of, or with respect to, any transportation of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission under the Natural Gas Act do not apply to such transportation by reason of subparagraph (A) of this paragraph.

(b) Charges deemed just and reasonable.—

(1) Sales.—

(A) First Sales.—Subject to paragraph (4), for purposes of sections 4[717c] and 5[717d] of the Natural Gas Act, any amount paid in any first sale of natural gas shall be deemed to be just and reasonable if—

(i) such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter; or

(ii) there is no applicable maximum lawful price solely by reason of the elimination of price controls pursuant to part B of subchapter I of this chapter.

(B) Emergency sales.—For purposes of sections 4[717c] and 5[717d] of the Natural Gas Act, any amount paid in any sale authorized under section 302[3362](a) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established under such section and applicable to such sale.

(C) Sales by intrastate pipelines.—For purposes of sections 4[717c] and 5[717d] of the Natural Gas Act, any amount paid in any sale authorized by the Commission under section 311[3371](b) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established by the Commission and applicable to such sale.

(D) Assignments.—For purposes of sections 4 [717c] and 5[717d] of the Natural Gas Act, any amount paid pursuant to the terms of any contract with respect to that portion of which the Commission has authorized an assignment under

section 312[3372](a) of this title shall be deemed to be just and reasonable if such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter.

(E) Affiliated entities limitation.—For purposes of paragraph (1), in the case of any first sale between any interstate pipeline and any affiliate of such pipeline, any amount paid in any first sale shall be deemed to be just and reasonable if, in addition to satisfying the requirements of such paragraph, such amount does not exceed the amount paid in comparable first sales between persons not affiliated with such interstate pipeline.

(2) Other charges.—

(A) Allocation.—For purposes of sections 4 [717c] and 5[717d] of the Natural Gas Act, any amount paid by any interstate pipeline for transportation, storage, delivery or other services provided pursuant to any order under section 303 [3363](b), (c), or (d) of this title shall be deemed to be just and reasonable if such amount is prescribed by the President under Section 303 [3363] (h)(1) of this title.

(B) Transportation.—For purposes of sections 4[717c] and 5[717d] of the Natural Gas Act, any amount paid by any interstate pipeline for any transportation authorized by the Commission under section 311[3371](a) of this title shall be deemed to be just and reasonable if such amount does not exceed that approved by the Commission under such section.

(c) Guaranteed passthrough.—

(1) Certificate may not be denied based upon price.—The Commission may not deny, or condition the grant

of, any certificate under section 7[717f] of the Natural Gas Act based upon the amount paid in any sale of natural gas, if such amount is deemed to be just and reasonable under subsection (b) of this section.

(2) Recovery of just and reasonable prices paid.—For purposes of sections 4[717c] and 5[717d] of the Natural Gas Act, the Commission may not deny any interstate pipeline recovery of any amount paid with respect to any purchase of natural gas if—

(A) under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4[717c] and 5[717d] of such Act, and

(B) such recovery is not inconsistent with any requirement of any rule under section 201[3341] of this title (including any amendment under section 202[3342] of this title),

except to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds.

Section 602(a), 15 U.S.C. 3432(a):

Authority to prescribe lower minimum lawful prices.—Nothing in this chapter shall affect the authority of any State to establish or enforce any maximum lawful price for the first sale of natural gas produced in such State which does not exceed the applicable maximum lawful price, if any, under subchapter [Title] 1 of this chapter.

Office-Supreme Court, U.S.
FILED
JUL 15 1985
ALEXANDER L. STEVAS,
CLERK

No. 84-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and
COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

BRIEF FOR THE APPELLEE, GETTY OIL COMPANY

WALKER L. WATTERS
(Counsel of Record)
DAVID T. COBB
GERALD, BRAND, WATTERS,
COX & HEMLEBEN
400 Lamar Life Building
Post Office Box 158
Jackson, Mississippi 39205
Telephone: (601) 948-3030

LARRY PORT
Post Office Box 60252
New Orleans, Louisiana 70160
Telephone: (504) 595-1295

Attorneys for Appellee,
Getty Oil Company

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

BEST AVAILABLE COPY

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
STATEMENT OF CASE	1
A. Jurisdiction Over Ratable Taking	1
B. Natural Gas Act, Phillips Case and Northern Natural Gas Company Case	3
C. Gas Shortage and the Natural Gas Policy Act of 1978	5
D. Transco's Refusal to Take Ratably and Rule 48 Proceedings	6
SUMMARY OF THE ARGUMENT	9
I. Rule 48 is not preempted by the NGA and NGPA	9
II. Rule 48 does not violate the Commerce Clause	10
ARGUMENT	11
I. Rule 48 is not preempted by the NGA and NGPA	11
A. Background of Act and Scope of Section 601	11
B. Decisions Construing Section 601	18
C. Preemption Cases	22
D. Additional Response to Claims in Transco and Amici Briefs	24
II. Rule 48 does not violate the Commerce Clause	27
A. Rule 48 Regulates Evenhandedly	28
B. Rule 48 Effectuates A Legitimate Local Interest	29
C. The Burden Imposed on Interstate Commerce Is Not Clearly Excessive In Relation to the Local Putative Benefits	30
C(1). Does Rule 48 Require Transco to Take to Take More Mississippi Gas?	31
C(2). Rule 48 Does Not Cause An Excessive Burden On Interstate Commerce Through Increased Take or Pay Costs	32
D. Can The Burden Be Promoted As Well With A Lesser Impact On Intrastate Commerce?	36
CONCLUSION	38
APPENDIX A	1a

TABLE OF AUTHORITIES

CASES — Page

Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, 461 U.S. 375 (1983) 22, 23, 24, 36

Champlin Refining Co. v. Corporation Commission, 286 U.S. 210 (1932) 3

Cities Service Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179 (1950) 3, 27, 30, 34, 35

Conoco, Inc. v. Federal Energy Regulatory Commission, 622 F.2d 796 (5th Cir. 1980) 18

Exxon Corporation v. Eagerton, 462 U.S. 176 (1983) . 25

Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978) 33

Florida Lime and Avocado Growers, Inc. v. Paul, 373 U.S. 132 (1963) 23

FPC v. Corporation Commission, 362 F.Supp. 522 (W.D. Okla. 1973), *aff'd* 415 U.S. 961 (1974) 29

Hines v. Davidowitz, 312 U.S. 52 (1941) 22

Maryland v. Louisiana, 451 U.S. 724 (1981) 25

Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456 (1981) 33

New York State Department of Social Services v. Dublene, 413 U.S. 405, 415 (1973) 23

Northern Natural Gas Corp. v. State Corporation Commission, 372 U.S. 84 (1963) ..... *passim*

Pacific Gas & Elec. Co. v. State Energy Resources Development Comm'n., 461 U.S. 190, 76 L.Ed.2d (1983) 23

Pennsylvania v. West Virginia, 262 U.S. 553 (1923) ... 28

Penn Terra Limited v. Department of Environmental Resources, Commonwealth of Pennsylvania, 733 F.2d 267 (1984) 23, 24

Phillips Petroleum Co. v. Wisconsin, 347 U.S. 672 (1954) 3, 4

Pike v. Bruce Church, Inc., 397 U.S. 137 (1970) 10, 27, 28, 29

Public Service Commission v. Mid-Louisiana Gas Co., 463 U.S. 319 (1983) 35

Table of Authorities Continued

	Page
Ray v. Atlantic Richfield Co., 435 U.S. 151, 157 (1978)	23
Rice v. Santa Fe Elevator Corp., 331 U.S. 218 (1947) .	22
Tenneco, Inc. v. Sutton, 530 F.Supp. 411 (M.D. La. 1981)	18, 19, 25, 26
Transcontinental Gas Pipeline Corp. v. State Oil and Gas Board, 457 So.2d 1298 (Miss. 1984)	37
STATUTES:	
Natural Gas Act, 15 USCA § 717-717(z)	3
Section 1(b), 15 USCA § 717(b)	3, 13, 15
Section 2a(6), 15 USCA § 717a(6)	15, 16
Section 107, 15 USCA § 3317	*passim*
Section 107(c), 15 USCA § 3317(c)	6
Section 601, 15 USCA § 3431	*passim*
Section 601(a)(1)(D), 15 USCA § 3431(a)(1)(D)	15
Section 601(a)(1)(A), (B), or (C), 15 USCA § 3431(a)(1)(A), (B), or (C)	16
Section 601(c)(2), 15 USCA § 3431(c)(2)	25
Miss. Code Ann. § 53-3-1, *et. seq.* (1972)	3
MISCELLANEOUS	
124 Cong. Rec 29101 (1978)	6, 12, 13
124 Cong. Rec 29103 (1978)	12
124 Cong. Rec 29100-29103 (1978)	13
124 Cong. Rec 30012-30014 (1978)	13
124 Cong. Rec 30025-30026 (1978)	13
43 Fed. Reg. 56455-58 (1978)	18
47 Fed. Reg. 6253 (1962)	26
Hardwick, "The Rule of Capture and Its Simplications As Applied to Oil and Gas," 13 Tex. L.Rev 391 (1935)	2
H.R. Rep. 1752, 95th Cong., 2nd Sess. (1978) at 123 ..	14
H.R. Rep. 1752, 95th Cong. 2nd Sess. (1978) at 71 ...	14
Johnston, Natural Gas Sales Contracts, 34th Institute on Oil & Gas Law, Southwest Legal Foundation 83	5, 31, 34

Table of Authorities Continued

Page

Moody, The Natural Gas Policy Act of 1978: Analysis and Overview, Twenty-Fifth Annual Rocky Mountain Law Institute 2-1 (1979) 11

Pierce, Natural Gas Regulation, Deregulation and Contracts, 68 Va L.Rev. 63, 87-88 (1982) 30

S. Conf. Rep. 1126, 95th Cong. 2nd Sess. (1978) at 123 14

S. Conf. Rep. 1126, 95th Cong. 2nd Sess. (1978) at 71 . 14

Statewide Rule 48 of the State Oil and Gas Board of Mississippi ..... *passim*

7 U.S. Code Cong. and Adm. News, 1978 at 8987 14

7 U.S. Code Cong. and Adm. News, 1978 at 9040 14

Williams, Federal Preemption of State Conservation Laws After the Natural Gas Policy Act: A Preliminary Look, 56 U. Colo. L.Rev., 901-916 (1985) 19, 20, 22, 26, 36

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

BRIEF FOR THE APPELLEE, GETTY OIL COMPANY

STATEMENT OF THE CASE

A. Jurisdiction Over Ratable Taking.

The physical properties of gas make it necessary to regulate the taking of gas from reservoirs so that each party owning an interest in a gas reservoir will obtain his fair share of production. The problem presented in this case is described in a similar ratable take case, *Northern Natural*

Gas Corp. v. State Corporation Commission, 362 P.2d 599 (Kan. 1961):

> We do not read the record to show that there is any contention but that drainage was occurring, and that the underproduced wells were losing the right to produce gas from the common source of supply to the great damage of the owners of the wells and the loss of the correlative rights.
>
> While members of this Court make no claim to be experts in the science of the production of natural gas, we believe that the Court may take judicial notice of the fact that where natural gas is in the earth in one common source and is under pressure, if one gas well is allowed to take gas, this will result in the pressure being lowered around the vicinity of this gas well so that the gas in the common source will tend to drain or rush to the vicinity of the well taking gas. The result will be that the other wells in the common field of source will be able to produce much less gas and the owners of such wells will have suffered a definite loss.

Under the "Rule of Capture", which applies in Mississippi and the United States, the owner of a tract of land acquires title to the oil and gas which he produces from the wells drilled thereon, though it may be proved that part of such oil or gas migrated from adjoining lands. Hardwick, "The Rule of Capture And Its Simplications As Applied To Oil And Gas," 13 Texas Law Review 391 at 393 (1935). Under this rule, a landowner with a producing well on his tract is not liable to adjacent landowners whose lands are drained as a result of such operations. The remedy of the injured landowner under such circumstances has generally been said to be that of self-help—"go and do likewise". The rule of capture made it economically imperative that each mineral

owner drill his land and produce at as rapid a pace as possible, for otherwise his land would be drained of oil and gas by wells under adjacent tracts. However, where gas production is involved, the problem is even more complicated. Gas can only be produced by a well when there is a pipe line willing to transport the gas to a market. To protect all of the owners in a pool in situations where an owner of a well did not have a market for his gas, the producing states enacted legislation commonly called "common purchaser statutes" or "ratable take rules" which guaranteed a market for all owners of interest in producing wells. Under the statutes and rules if a purchaser purchases production from one owner in a gas pool or oil pool, then he must make a market available for all owners in the pool who do not otherwise have a market. e.g. § 53-3-1, *et. seq.*, Mississippi Code of 1972 and Rule 48 of the Mississippi State Oil and Gas Board promulgated thereunder. Constitutionality of these statutes has long been recognized. *Champlin Refining Co. v. Corporate Commission of Oklahoma*, 286 U.S. 210 (1932); *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179, (1950).

B. Natural Gas Act, Phillips Case and Northern Natural Gas Company Case

In 1938, Congress determined that there should be federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate commerce and passed the Natural Gas Act. 15 U.S.C.A. §§ 717-717(z). Section 1(b) of the Act (§ 717(b)) provides that the Act shall apply "to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for alternate public consumption for domestic, commercial, industrial or any other use, and to natural gas companies engaged in such transportation or sale. . . ." In *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954),

this Court applied the Natural Gas Act to sales of gas from independent producers to interstate pipe lines. As a result of the *Phillips* decision, no interstate pipeline company could purchase gas without the approval of the Federal Power Commission ("FPC"). The FPC controlled the price paid for gas in acquisitions by pipe line companies. Under the regulatory scheme created by the Natural Gas Act, no room was left either for direct state regulation of the prices of interstate wholesales of natural gas, or for state regulations which would directly achieve the same result. *Northern Natural Gas Corp. v. State Corporation Commission*, 372 U.S. 84 (1963) (holding that a ratable take statute indirectly affected the price of gas and therefore was preempted by the Natural Gas Act). Furthermore, gas, once transported and sold in interstate commerce could not be removed from the interstate market without the consent of the FPC through abandonment proceedings.

The result of this federal regulation was the establishment of an artificially low price for gas sold in interstate commerce. The FPC would only allow gas to be sold into the interstate market at a price which it approved. The price which the FPC approved was an artificially low price. Once a producer sold gas in the interstate market, he could not subsequently remove it from the interstate market for a higher intrastate sales price without the approval of the FPC. The result was two-fold. Initially, oil and gas operators simply did not drill gas prospects since the only substantial market was the interstate market and the price which the FPC would allow for gas sold in the intrastate market did not justify the drilling of exploratory wells to discover new gas reserves. Later, when the intrastate market developed, producers sold any newly discovered gas which was not previously committed to the interstate market to intrastate customers because the price which intra-

state customers were willing to pay was the market price of the gas and was considerably higher than the artificially lower interstate price allowed by the FPC.

C. Gas Shortage and the Natural Gas Policy Act of 1978

The result of the federal regulation by the FPC under the Natural Gas Act of 1938 was a gas shortage by the 1970's. The artificially low price established by the FPC resulted in an increased demand for natural gas as users of other fuels switched to natural gas which was cheaper. Exploration for development of new gas supplies decreased since the FPC imposed ceiling prices did not reflect inherently increasing costs incurred in the producing industry. Gas reserves were depleted and were not replaced by new supplies. Beginning about 1971, interstate pipelines began to "curtail" customers below their contract demands for lack of gas supply. From 1969 to 1977, reserves of new natural gas averaged about half the gas consumed each year. Johnston, Natural Gas Sales Contracts, 34th Institute on Oil and Gas Law, page 83.

On April 20, 1977, President Carter announced his "Moral Equivalent War" energy plan which was an attempt to resolve the energy crisis. Various bills were introduced into Congress seeking different approaches to resolve the problem. Some parties advocated continuing regulation of a different type while others advocated total deregulation. The result was a compromise called the Natural Gas Policy Act of 1978 ("NGPA"). Senator Ribicoff in one of the floor debates made the following statement:

> Certainly this conference report is not a perfect piece of legislation. It is not the program the President originally envisioned. It is not what those opposed to any deregulation or those supporting the industry desire. It is a compromise and is an important start.

124 Cong. Rec. 29101 (1978).

Under the compromise, for those who wanted continued regulation it imposed federal price controls on intrastate market for the first time. For those who proposed deregulation, it removed, in § 601(a)(1) high cost gas from the provisions of the Natural Gas Act and the jurisdiction of the Commission.

D. Transco's Refusal to Take Ratably and Rule 48 Proceedings

The following situation led to this litigation. These facts are not in dispute.

The Harper Sand Gas Pool is productive in both the Greens Creek Field and the East Morgantown Field. These two fields are contiguous. If only one well were completed in this pool and produced from this pool, it would drain the entire pool. J.A.-87; J.A.-91

The Getty-Rogers 28-11 Well, the Getty-Sipp 20-9 Well, the Tomlinson-Willoughby 3-5 Well, the Getty-Buckley 33-6 Well, the Florida Exploration-Carlisle 4-2 Well and the Florida Exploration 29-1 Well produce from the Harper Sand Gas Pool. The Harper Sand Gas Pool lies below 15,000 feet and all of the wells producing from this pool have been classified as deep, high-cost wells under Section 107(c) of the Natural Gas Policy Act of 1978, 15 U.S.C.A. § 3317(c) (NGPA). J.A. 88.

Transco has bought gas from Getty-operated wells in the Greens Creek and East Morgantown Fields since April, 1981. Although Transco has a gas contract with Getty to purchase Getty's gas, it did not negotiate gas purchase contracts with all of the working interest owners (persons owning leases or unleased mineral interests) in the Getty-operated units. Transco took the full production from each

Getty-operated well. J.A. 105. Pursuant to the operating agreements covering the Getty-operated units, Getty delivered to Transco the gas attributable to the working interest of those persons who had not contracted with Transco (nonsignatory parties). Transco paid to the nonsignatory parties the same price that it paid Getty under the terms and conditions of Getty's gas purchase contract with Transco. (JA-113) This practice was consistent with Rule 48, which forbids purchasers from discriminating in favor of one owner, operator or producer against another in the same common source of supply.

Shortly before June 1, 1982, Transco advised Getty Oil Company, operator of the Getty-Sipp 20-9 Well, the Getty-Rogers 28-11 Well, and the Getty-Buckley 33-6 Well, that effective July 1, 1982, it would take only that production attributable to the pro rata working interest of the owners who had executed gas sales contracts with Transco, and until further notice, would no longer take any gas delivered by the operator under the operating agreement. The same notice was sent to Tomlinson Interests, Inc., operator of the Tomlinson-Willoughby 35 Well and other wells in said fields. J.A. 41; J.A. 61.

Upon receipt of this notice, Getty notified the nonoperators (parties owning leases and unleased mineral interests) in the units which it operated who did not have gas sales agreements with Transco (nonsignatory parties) about Transco's decision not to purchase gas from nonsignatory parties under the operating agreement. Tomlinson also notified the nonoperators in the units it operated of this decision. J.A. 39; J.A. 48.

In July, 1982, Transco wrote the nonsignatory working interest owners in the Getty operated units that it would

buy their gas on terms less favorable than those contained in the Getty contract with Transco. J.A. 66.

In response to Transco's notice that it would purchase only that gas attributable to the pro rata working interest of the signatory parties, Getty reduced its July, 1982 deliveries from each of its wells producing from the Harper Sand Gas Pool. Transco was obligated to take all of the production from Florida Exploration-Carlisle 4-2 Well and the Florida Exploration-Barnes 29-1 Wells (located on adjoining units) and continued to take one hundred percent of production from said wells. J.A. 136.

Coastal Exploration, Inc. ("Coastal") owns a small undivided working interest in the Getty-Rogers 28-11 Well, the Getty-Sipp 20-9 Well, the Tomlinson-Willoughby 3-5 Well and the Florida Exploration-Barnes 29-1 Well. (JA-29) Coastal has not signed a gas sales contract with Transco, and accordingly, was a nonsignatory nonoperator who received the above notices and letters. J.A. 66; J.A. 71.

On July 29, 1982, in Docket Nos. 287-82-418 and 287-82-467, Coastal filed a petition with the State Oil and Gas Board of Mississippi to require Transco to comply with Statewide Rule 48 by ratably taking and purchasing gas from wells producing from a common pool in the Greens Creek and East Morgantown Fields without discrimination in favor of the operators of the wells as against Coastal. J.A. 1-2.

The matter was heard by the Board at its September, 1982 meeting. The evidence showed that Transco refused to take from the Getty operated wells any amounts in excess of the pro rata share of interests that Transco was contractually obligated to take and consequently were not taking ratably from the field. J.A. 137. The Board ordered Transco to take ratably and purchase without discrimina-

tion. J.S.App. C at 112(a). On appeal the Mississippi Supreme Court affirmed the Board's Order to the extent it requested Transco to take and purchase gas ratably from all owners in a common pool. It reversed any part of the Order that required Transco to pay at the Getty-Transco contract price stating that Rule 48 just applied to quantity and not to price. J. S. App. A at 48a-44a. The Court overruled Transco's claims that the Board's Order violate Transco's preemption and commerce clause defense.

SUMMARY OF ARGUMENT

I. Rule 48 Is Not Preempted By The NGA Or The NGPA

The Natural Gas Policy Act of 1978 (NGPA) was a result of the gas shortage in the 1970's. The floor debates and the committee reports indicate a recognition by Congress that past regulation of interstate gas had caused the shortage and an intention by Congress to provide some deregulation to stimulate development of new gas reserves.

Members of Congress were divided on how much regulation should continue and how much should be removed. The final act which was passed by Congress was a compromise. Overall the act moved in the direction of deregulation. To appease those seeking continued regulation, FERC acquired jurisdiction over intrastate sales. To appease those seeking deregulation, first sales of Section 107 High Cost Gas were completely deregulated.

In clear terms in Section 601 of the act first sales of High Cost Gas was removed from regulation under the Natural Gas Act (NGA). The result was that the impact of *Northern Natural* on ratable take rules was removed since it was based upon NGA jurisdiction over first sales of natural gas. Now that these sales of High Cost Gas are no longer subject to federal jurisdiction under the Natural Gas Act and

Northern Natural is no longer applicable, ratable take rules such as Rule 48 of the Mississippi Oil and Gas Board are no longer preempted.

II. Rule 48 Does Not Violate The Commerce Clause

Rule 48 produces two primary results. First, it protects the rights of all parties in an oil or gas reservoir so that each owner can obtain his fair share of production. Secondly, it promotes development of oil and gas since parties risking exploration dollars will be assured that they will be able to market any oil or gas they encounter; this same reason makes it easier for them to obtain the financing necessary for drilling.

The test to determine whether a state action violates the Commerce Clause of the Constitution is best set forth in *Pike v. Bruce Church*, 397 U.S. 137 (1970). Rule 48 and Order No. 409-82 promulgated thereunder comply with this test.

First, Rule 48 regulates evenhandedly. It treats Mississippi citizens and non-residents in a non-discriminating manner.

Secondly, it effectuates a legitimate local public interest. The protection of the rights of all owners in an oil or gas pool and the promotion of development of natural resources has long been recognized as a legitimate local interest.

Thirdly, the burden imposed on interstate commerce is not clearly excessive in relation to the putative local benefits. In fact it is Getty's position that Rule 48 is a benefit, not a burden to interstate commerce, since it encourages production of gas for the interstate market. Even if the take or pay costs referred to by Transco are a burden, they are a burden caused by Transco through its gas contract and cannot be laid upon Rule 48.

Finally, there are no alternative means of accomplishing the same result with lesser impact on interstate activities. If the sole regulation is on producers and not on purchasers, then purchasers will control production in all states. If a pipeline purchaser refuses to take ratably, then ratable production is impossible because an operator can only produce that which a pipeline purchaser will take. This will have the effect of passing production controls to interstate pipelines. This is contrary to the long recognized regulatory scheme wherein states have jurisdiction over production. Finally this standard is not even reached since there is no undue burden on interstate commerce imposed by Rule 48.

Therefore, Rule 48 meets all of the above tests and does not violate the commerce clause.

ARGUMENT

I. Rule 48 is Not Preempted Because the Natural Gas Policy Act of 1978 Removed First Sales of Section 107 Gas From Federal Jurisdiction Under the Natural Gas Act.

A. Background of Act and Scope of Section 601.

As mentioned previously, federal regulation of first sales of gas into the interstate market met with disastrous results. Few producers were willing to explore for gas and sell it in the interstate market due to the regulatory burdens. This is described in Rush Moody's Article: The Natural Gas Policy Act of 1978: Analysis and Overview, Twenty-Fifth Annual Rocky Mountain Law Institute 21 (1979) wherein he analyzes Section 601 of the NGPA.

> Under the Natural Gas Act, FERC is authorized, and indeed required, to regulate interstate transportation of natural gas and sales for resale in interstate commerce. This regulation extends not only to wellhead pricing but also to the entry into and abandonment

> from the interstate market. By way of marked contrast, gas not committed or dedicated to the interstate market is not so regulated, absent a comparable state regulatory scheme. *Given this dichotomy of regulation, many producers have been reluctant to sell their production in the interstate market for fear of being subject to this federal regulatory structure. Section 601 of the NGPA was enacted in order to remove certain sales and transportation arrangements from FERC jurisdiction under the NGA, and to thereby eliminate many of the actual and psychological impediments to the introduction of more natural gas to the interstate market.* (Emphasis added)

During the legislative hearings which preceded the enactment of the NGPA, it was apparent to all parties that some deregulation was necessary to counteract the diminishing flow of gas into the interstate market. The floor debates are replete with speeches urging the necessity for deregulation. For example, Senator Bellmon stated:

> There can be no doubt as to why there is plenty of gas in the unregulated market and shortages in the regulated market. There is plenty of gas in the unregulated market because that market is unregulated. It is that simple. There is a shortage of gas in the regulated market because that market is regulated. Seldom is any affliction so easily diagnosed. Seldom is any remedy so easily prescribed. *The affliction is federal regulation. The remedy is to end federal regulation.*

124 Cong. Rec. 29103 (1978). *See also*, 124 Cong. Rec. 29101 (1978) (Statement by Senator Ribicoff concerning burdensome FERC regulations).

The legislative history of the NGPA makes it abundantly clear that the NGPA was a *compromise* between those

groups who favored deregulation and those who were opposed to deregulation. For example, Senator Ribicoff in one of the many floor debates stated as follows:

> Certainly this conference report is not a perfect piece of legislation. It is not the program the President originally envisioned. It is not what those opposed to any deregulation or those supporting the industry desire. It is a *compromise* and is an important start.

124 Cong. Rec. 29101 (1978). *See also*, 124 Cong. Rec. 29100-29103 (1978); 124 Cong. Rec. 30012-30014 (1978); 124 Cong. Rec. 30025-30026 (1978).

Under the compromise, those favoring continued regulation obtained provisions subjecting intrastate gas sales to FERC jurisdiction. For those favoring deregulation there was a total deregulation of sales of Section 107 High Cost Gas. The Joint Explanatory Statement of the Committee on Conference, which accompanied the NGPA, shows that Congress *intended* to remove high cost natural gas from FERC's dominion and control by enacting Section 601 of the NGPA. The Joint Explanatory Statement explains as follows:

> The conference agreement limits the jurisdiction of the commission under the Natural Gas Act in a manner similar to the House-passed bill.
>
> Natural gas not committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act is never made subject to the commission's jurisdiction under Section 1(b) of the Natural Gas Act. The commission's jurisdiction under Section 1(b) of the Natural Gas Act ceases after the date of enactment of this Act for the following categories of natural gas:

> High-cost natural gas which qualifies for deregulated price treatment under Section 107(c)(1), (2), (3) or (4).

H. R. Rep. 1752, 95th Cong., 2nd Sess. 123 (1978); S. Conf. Rep. 1126, 95th Cong., 2nd Sess. 123 (1978); *reprinted in* 7 U.S. Code Cong. and Adm. News, 1978 at 9040.

The Joint Explanatory Statement makes it abundantly clear that the deregulation of Section 107 High Cost Gas was not mere price deregulation, but was *total* deregulation.

> Committed or dedicated to interstate commerce
>
> The term committed or dedicated to interstate commerce, for purposes of this Act, means natural gas from the outer continental shelf and most natural gas which if sold, would be required to be sold in interstate commerce within the meaning of the Natural Gas Act. The definition is intended by the conferees to clarify any uncertainty resulting from recent court decisions as to what natural gas may qualify under what price categories in Title 1 of this Act, and what natural gas may qualify for non-price deregulation in Title 6 of this Act.

H. R. Rep. 1752, 95th Cong. 2nd Sess. 71 (1978); S. Conf. Rep. 1126, 95th Cong. 2nd Sess. 71 (1978); *reprinted in* 7 U.S. Code Cong. and Adm. News, 1978 at 8987. Not only does the legislative history show that Congress intended to remove Section 107 High Cost Gas from federal jurisdiction, the wording of Section 601 of the NGPA is explicit in this removal:

> Section 601 Coordination with the Natural Gas Act.
>
> (a) Jurisdiction of the Commission under the Natural Gas Act.
>
> (1) Sales—

> (A) Natural Gas Not Committed or Dedicated.—For purposes of Section 1(b) of the Natural Gas Act, effective on the first day of the first month beginning after the date of the enactment of this Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply to natural gas which was not committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act solely by reason of any first sale of such natural gas.
>
> (B) Committed or Dedicated Natural Gas.—Effective beginning on the first day of the first month beginning after the date of the enactment of this Act, for purposes of Section 1(b) of the Natural Gas Act, the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act and which is—
>
> (i) high-cost natural gas (as defined in Section 107(c)(1), (2), (3), or (4) of this Act). . . .

Moreover, with respect to the status of pipeline purchasers of deregulated gas, Section 601(a)(1)(D)[1] of the Natural Gas Policy Act provides as follows:

> D. Natural Gas Company—For purposes of the Natural Gas Act, the term 'natural gas company' (as defined in Section 2(6)[2] of such Act) shall not include any person

---

[1]15 U.S.C.A. § 3431(a)(1)(D).

[2]15 U.S.C.A. § 717a(6).

> by reason of, or with respect to, any sale of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission do not apply to such sale solely by reason of subparagraph (A), (B), or (C) of this paragraph.

Section 2(6) of the Natural Gas Act defines a "natural gas company" as "a person engaged in the transportation of natural gas in interstate commerce, for the sale in interstate commerce of such gas for resale."

Read together, these statutory passages directly affect Transco's status as a purchaser of natural gas. When Transco purchases gas which is removed from FERC's jurisdiction by Section 601(a) (1)(A), (B), or (C), as to those purchases, Transco, too, is removed from the FERC's NGA jurisdiction, for it is no longer a "natural gas company" subject to FERC's jurisdiction under the NGA. Although FERC's NGA jurisdiction over Transco remains as to the *transportation* of gas in interstate commerce, the NGPA expressly provides that Transco, as a *purchaser* of this deregulated gas, is not regulated by FERC.

Thus, the *Northern Natural* decision is clearly inapplicable as to Transco's purchases of deregulated gas such as the Harper Sand Gas Pool. Both the gas in question and the pipe line which purchases it are, by the operation of the Natural Gas Policy Act, removed from the ambit of the Natural Gas Act. With respect to deregulated gas, FERC's jurisdiction over Transco's activities begins in the transportation link of the interstate pipe line system. Transco's field purchases of deregulated gas are not regulated by the Commission. FERC's authority, which is defined by Section 1(b) of the Natural Gas Act, and which is circumscribed by the operation of the Natural Gas Policy Act, does not, in the case of deregulated gas, back up to the wellhead. Such an assertion

is, when read in light of the applicable statutes, impossible. Such an interpretation of the NGPA would make Section 601 and the intent of Congress in enacting the NGPA meaningless.

Finally, it is worth noting FERC's recognition of deregulation of High Cost Gas under the NGPA. In the preamble to its interim rules implementing the Natural Gas Policy Act, FERC explained the effect of the NGPA upon continued NGA regulation:

> If gas is not committed or dedicated to interstate commerce as defined in Section 2(18) or is exempted from the jurisdiction of the NGA under Section 601(a)(1)(B) as high cost natural gas, new natural gas, or natural gas produced from any new onshore production well, the prior framework of utility type regulation under the NGA no longer applies.
>
> If natural gas sales are freed from the requirements of the NGA, several adjuncts to NGA regulation are obviated. First, there is no longer any necessity for a producer to seek certification of the sale as serving the public convenience and necessity. The replacement for this requirement under the NGPA is limited to the prior determination mechanism, where applicable, and the pricing limits established in the NGPA. New sales of such gas in interstate commerce no longer require certification as a prerequisite to commencement of deliveries. Nor does the requirement for abandonment authorization before termination of deliveries of natural gas exist with respect to natural gas no longer subject to NGA regulation. In the case of first sales of natural gas not previously committed or dedicated to interstate commerce or exempted from NGA regulation, tariff

> filings and rate increase applications are dispensed with.

43 Fed. Reg. 56455-58 (1978).

B. Decisions Construing Section 601

Cases construing Section 601 of the NGPA recognize that the first sales of Section 107 High Cost Natural Gas have been removed from federal jurisdiction.

In *Conoco, Inc. v. Federal Energy Regulatory Commission*, 622 F.2d 796, (5th Cir. 1980), the Fifth Circuit explained the effect of Section 601:

> Section 601(a) of NGPA, 15 U.S.C.A. Section 3431(a), exempts certain categories of natural gas from the jurisdiction of FERC and the requirement of obtaining a certificate of public necessity under NGA . . . . It is clear from Section 601 that Congress intended to free certain natural gas from FERC jurisdiction, while leaving other gas subject to that jurisdiction.

Id. at 797, and 799.

In *Tenneco, Inc. v. Sutton*, 530 F. Supp. 411 (M.D. La. 1981), the District Court there succinctly summarized the effect of the NGPA:

> The NGPA is basically an overlay of the NGA since the NGA remains applicable to interstate transportation and interstate sales for resale, *unless a specific exclusion of the NGA jurisdiction is provided.* The NGPA eliminates many of the NGA's price and non-price producer regulations. Under the provisions of the NGPA, the NGA is inapplicable after November 3 1980 [sic], to first sales of natural gas which were not committed or dedicated to interstate commerce on November 8, 1978, and to first sales of committed or dedicated gas

> which have been determined to be new natural gas, new onshore production well gas, or within certain categories of high cost gas. *These provisions remove the Commission's authority to establish just and reasonable prices under the NGA for producer sales into the interstate market and to indirectly regulate these sales through control of the interstate pipe line purchaser's pass-through of purchase gas costs.* These provisions also relieve producers of gas not committed or dedicated to interstate commerce and gas in the new natural gas and new onshore production well categories, from any requirement of receiving certification or abandonment authorization, or of making rate filings under the NGA.
>
> Impediments to producer sales into the interstate market of natural gas which was not committed to that market at the time the NGPA was enacted are eliminated.

Id. at 419. (Emphasis added)

These decisions are consistent with the legislative history and the clear wording of Section 601 of the NGPA; first sales of Section 107 High Cost Gas are removed from federal jurisdiction.

A thorough examination of Rule 48 as affected by the NGPA is given in Steven P. Williams' article, Federal Preemption of State Conservation Laws After the Natural Gas Policy Act: A Preliminary Look, 56 University of Colorado Law Review, pages 901-916. This article (which will be printed in August, 1985), presents a complete analysis of preemption, *Northern Natural* and state conservation laws after the NGPA. (The page cites for this article are from galley proofs and are tentative.) The ratable take order

rendered by the Mississippi State Oil and Gas Board seems consistent with the federal program, initiated in the NGPA:

> As construed by the court, the Mississippi Board's authority seems presumptively consistent with the federal program. It appears well designed to correct a potential market failure in sales of gas at the wellhead. The possible market failure arises from two sources. First, economics of scale make it probable that there will be only a few pipe line buyers in any one field (sometimes only one). Second, a producer without a purchaser suffers the risk, under the Rule of Capture, of seeing gas extracted from his property by fellow producers and sold without his realizing a nickle. As a result, monopsonistic or oligopsonistic pipe lines might manipulate producers and generate the standard consequences of monopsony or oligopsony: sales in lower quantity and at a lower price than would prevail under competitive conditions. Coupled with these effects is a distributional one, that the owner of the property interest in the gas would lose it without compensation (the problem of 'correlative rights'). The Mississippi Board's authority (as limited by the court) can be viewed as remedying the market failure with roughly the minimum feasible market distortions. The mandate of the Mississippi Board is evidently to mimic a market free of monopsony or oligopsony.

Id. at 908.

Professor Williams is very perceptive in his analysis. Transco and FERC are attempting to lead the country back into federal regulation which will assure the country of returning to the same gas shortage which occurred in the 1970's. When the only objective of the natural gas policy is to produce gas to the interstate market at the lowest price,

then the system won't work. Consideration must also be given to the exploration and production of those gas supplies. Without exploration and production there will be no future gas supplies. Take or pay contracts encourage exploration because it enables a producer to obtain financing for his exploration. A lender will be more likely to lend money if he can be assured that his borrower will be assured a steady income through take or pay contract provisions. Likewise, if an operator knows that he will have a market for any gas that he might discover (under ratable take rules or otherwise), then he will be more likely to risk the investment necessary to drill a well. He will be less likely to spend the money drilling a well if there is a possibility that the pipe line into the field will refuse, and be permitted to refuse, to provide him a market for his gas. In this case, the gas underlying his well will be drained to and produced by wells on adjoining land and he will not be able to recover his investment. Ratable taking under Rule 48 helps to ensure a healthy, competitive gas supply which is the policy manifested by the NGPA.

Considering the consistency of ratable taking and the goals evidenced by the NGPA, Professor Williams concludes that ratable take orders should not be preempted under Northern Natural:

> Adoption of the NGPA established as the longrun goal of federal natural gas policy the establishment of a competitive wellhead market free of price controls. Federal adoption of that goal undermines the premise of *Northern Natural* that any state action that risked increasing the price of natural gas for ultimate consumers was necessarily preempted. The primary standard should now be whether the state action is congruent with development of the sort of market that Congress sought to achieve.

Id. at 915-916.

C. Preemption Cases

In *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941), the Supreme Court stated that a state law is preempted if it "stands as an obstacle to the accomplishment of the full purposes and objectives of Congress." And in *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 236 (1947), the Court noted that the test of preemption is whether "the matter on which the State asserts the right to act is in any way regulated by the federal government." Here, it is the stated objective of Congress to increase the supply of gas in the interstate market by removing certain categories of gas from the web of FERC's jurisdiction. Congress has expressly removed from FERC's purview wellhead sales of deregulated gas.

Furthermore, Transco's assertion that Order No. 409-82 interferes with FERC's pervasive interest in regulation of the sale of natural gas in interstate commerce does not by itself lead to the conclusion that the Board is preempted from applying Rule 48 to an interstate gas pipe line. In *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 375 (1983) 76 L.Ed.2d 1 (1983), AEEC and the United States, as *amicus curiae*, argued that the Arkansas PSC's assertion of jurisdiction interfered with the federal Rural Electrification Administration's "pervasive involvement in the management of the rural power cooperatives to which it loans funds, and may frustrate important federal interests." *Id.* at 11. The Court ignored this broad assertion and instead analyzed the true relation between the Rural Electrification Act and State regulatory jurisdiction over wholesale electricity rates as explained in the legislative history of that Act:

> Contrary to the suggestion in the dissent, we do not infer from this legislative history that Congress either

> 'authorized' or 'expected' state regulation that this Court had barred states from engaging in. [Citations omitted] The relevant inquiry, however, is not whether Congress authorized or expected such regulation, but whether it intended by its own actions to forbid it. Cf. *Pacific Gas & Elec. Co. v. State Energy Resources Development Comm'n*, 461 U.S. 190 (1983). In answering that question, we look quite naturally to whether Congress intended in any way to forbid state regulation of rural power cooperatives.

Id. at 12, n. 11.

Federal regulation of a field of commerce should not be deemed preemptive of state regulatory power unless either the nature of the regulation permits no other conclusion or Congress has made its intent to preempt state regulation unsuitably clear. *Florida Line and Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142, (1963). A court cannot infer an intent to preempt merely from the comprehensive character of complex legislation. *New York State Department of Social Services v. Dubleno*, 413 U.S. 405, 415, (1973). Where an exercise by a state of its police power is attacked there is a presumption against a congressional intention to preempt in the absence of a clear and manifest expression by Congress favoring it, or an evident public purpose which would be forestalled were preemption not found to have occurred. *Ray v. Atlantic Richfield Co.*, 435 U.S. 151, 157, (1978). Nothing here suggests a manifest necessity for preemption, in fact, the contrary is true; the necessity in this case is no preemption and a viable market at the wellhead. *Penn Terra Limited v. Department of Environmental Resources, Commonwealth of Pennsylvania* 733 F.2d 267 (3rd Cir. 1984) is particularly pertinent to the applicability of preemption where vital interests such as the correlative rights of owners in a gas pool are involved:

> The police power of the several states embodies the main bulwark of protection by which they carry out their responsibilities to the people; its abrogation is therefore a serious matter. Congress should not be assumed, therefore, to have been miserly in its refund of that power to the States. Where important state law or general equitable principles protect some public interest, they should not be overridden by federal legislation unless they are inconsistent with explicit congressional intent such that the supremacy clause mandates their suppression.

Id. at 273

The message from Congress is not only clear, it is paramount: FERC's jurisdiction over Transco's field purchases of deregulated gas does not begin until after said gas has entered the transportation link of the interstate pipe line system. Since there is no jurisdiction, there is nothing to preempt, and Rule 48 an Order No. 409-82 do not violate the Supremacy Clause of the Constitution. *Northern Natural* no longer applies because it was undergirded by federal jurisdiction over first sales.

D. Additional Response to Claims in Transco and Amici Briefs

The foregoing argument should be determinative of the preemption question. However, there are specific assertions in the briefs of Transco and Amici which need to be answered.

When Transco cites *Arkansas Electric Cooperative Corporation v. Arkansas Public Service Commission* 461 U.S. 375 (1983), as holding that a federal decision not to regulate an area can have as much preemptive force as a decision to regulate, it incorrectly implies that this rule is applicable to the case at hand. In our case, Congress found that regula-

tion and price control of natural gas, which was established under the NGA regulatory scheme, has had the effect of stifling discovery and production for the interstate market. Congress determined that this effect could be reversed by initiating a different approach through federal deregulation of first sales of certain categories of natural gas. Furthermore, the Court in the case said, "the relevant inquiry, however, is not whether Congress authorized or expected such regulation, but whether it intended by its own actions to forbid it."

The ratable take provision involved in this case was simply not an issue in *Maryland v. Louisiana* 451 U.S. 724 (1981) and *Exxon Corporation v. Eagerton*, 462 U.S. 176 (1983). In those cases, Congress had not expressly removed the subject matter in issue from the ambit of FERC's regulatory power as it has here with respect to wellhead sales of deregulated gas.

Transco claims that Rule 48 and Order 409-82 is in conflict with ongoing FERC regulation of interstate pipelines which is in the form of an inquiry on possible discrimination of interstate pipelines. FERC has the authority under Section 601(C) (2) to deny Transco the right to pass through to its customers any costs that are "excessive due to fraud, abuse, or similar grounds". No doubt this is the basis upon which this inquiry is being made. If FERC determines that Transco's costs are excessive due to fraud, etc. then it can deny Transco the right to pass such excess through to its customers. In such case, Transco absorbs the excess. This power of FERC to determine whether costs are excessive does not give it any right to regulate the first sales of the gas which are expressly exempted by the act. The opinion in *Tenneco v. Sutton* 530 F.Supp. 411 (M.D. La. 1981), clearly states that FERC shall not have the authority to regulate pro-

ducer sales under the pass through jurisdiction of Section 601(C)(2):

> Under the provisions of the NGPA, the NGA is inapplicable after November 3, 1980 [sic], to first sales of natural gas which were not committed or dedicated to interstate commece on November 3, 1978, and to first sales of committed or dedicated gas which have been determined to be new natural gas, new onshore production well gas or within certain categories of high cost gas. *These provisions remove the Commission's jurisdiction to establish just and reasonable prices under the NGA for producer sales into the interstate market and to indirectly regulate these sales through control of the interstate pipeline purchaser's pass-through of purchase gas costs.*

Id. at 419.

Professor Williams states, "The Commission, however, has read the legislative history as establishing that its 'fraud or abuse' power is not to be be a 'backdoor' for 'regulation' of wellhead prices". Williams, *supra* at 901 (citing Statement of Policy, Fraud, Abuse Standard in Section 601(C)(2) of the NGPA, 47 Fed. Reg. 6253 (Feb. 11, 1962), FERC Statutes & Regulations Par. 30, 336).

Transco's argument that ratable take orders relate to "transportation" jurisdiction under the NGA is not valid. If the transportation argument were accepted, "transportation" jurisdiction would engulf the sales activities and render FERC's NGA "Sales" jurisdiction mere surplusage, and would be inconsistent with Congress' removal of certain "first sales" from FERC's jurisdiction by the NGPA.

Finally, the Amicus Brief filed by Associated Gas Distributors cites that portion of *Northern Natural* which

states that the ratable take orders shift to the shoulders of the interstate purchasers the burden of balancing production between wells. This is not an undue burden. All the pipeline purchaser needs to do is read the flow charts which measure the flow of gas from each well. This is normally done on a monthly or semimonthly basis and the flow charts can be mailed to the purchaser's office. Likely, the purchaser is already checking these flow charts to make sure that it is not taking more gas than it intends. Professor Steven Williams notes that this burden is trivial. Williams, *supra.*

II. Rule 48 and Order No. 409-82 Do Not Violate the Commerce Clause

This Court has previously upheld state ratable take orders such as Statewide Rule 48 when those orders were challenged under the Commerce Clause. *Cities Service Gas Co. v. Peerless Oil and Gas Co.*, 340 U.S. 179 (1950). Moreover, the holding in Cities Service that a ratable take order does not violate the Commerce Clause was specifically approved in this Court's decision in *Northern Natural Gas Co. v. State Corporation Commission*, 372 U.S. 84 (1963), upon which Transco relies so heavily in its jurisdictional statement. Nevertheless, Transco now asks this Court to ignore these precedents and find Statewide Rule 48 in violation of the Commerce Clause.

In *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), this Court set forth the following test to be applied in the Commerce Clause challenges:

> Where the statute regulated evenhandedly to effectuate a legitimate public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question

> becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

Id. at 142.

Thus, applying the *Pike v. Bruce Church* test, a state regulation will be upheld where:

1. It regulates evenhandedly;

2. to effectuate a legitimate local public interest;

3. unless the burden imposed on interstate commerce is clearly excessive in relation to the putative local benefits;

4. the extent of the burden to be tolerated depends on whether the local interest could be promoted as well with a lesser impact on interstate activities.

The following discussion will consider each of these standards of the *Pike v. Bruce Church, Inc.* decision.

A. Rule 48 Regulates Evenhandedly.

Statewide Rule 48 does not discriminate against Transco or any interstate company in favor of Mississippi producers. This rule applies evenhandedly to all field producers of oil and gas, be they interstate pipeline or local oil purchasers. Furthermore, Statewide Rule 48 does not restrict the flow of natural gas into the interstate market, a result of state regulation which was condemned in *Pennsylvania v. West Virginia*, 262 U.S.. 553 (1923), where a West Virginia statute required domestic gas producers to supply local needs first before allowing the surplus gas, if any, into the interstate market. Nor does it threaten to withdraw large reserves of natural gas from the interstate market as did the

Oklahoma Corporation Commission's order in *FPC v. Corporation Commission*, 362 F.Supp. 522 (W.D. Okla. 1973), *aff'd.* 415 U.S. 961 (1974). The Commerce Clause was meant to protect against the burdens on interstate commerce condemned in the abovementioned cases, and not against state ratable take requirements.

On the contrary, Rule 48 is a uniform, evenhanded prohibition on discriminatory purchasing practices by purchasers from a pool. Any purchaser, whether interstate or intrastate in nature, is subject to Statewide Rule 48, regardless of the destination for which the gas is purchased. Rule 48 regulates evenhandedly and satisfies this part of the *Pike v. Bruce Church, Inc.* test.

B. Rule 48 Effectuates a Legitimate Local Interest

Rule 48 is necessary to protect the coequal and correlative rights of all owners in an oil or gas pool. If there are any two wells completed in a gas pool and a pipeline takes all of the gas produced from one well and refuses to take gas from the second well, then the owners of the first well obtain all of the production from the pool under the Rule of Capture. The owners of the second well get nothing. Rule 48 protects against this abuse of the rights of owners in the pool and is a proper exercise of the states police power. The protection of these rights is a legitimate local interest.

Ratable taking provided under Rule 48 promotes development of natural resources. If an operator is assured of an access to a market under Rule 48, if he does successfully complete a well in a gas pool, then he is more likely to take the risk in drilling the well and he is more likely to obtain financing for the drilling. If Rule 48 does not apply to the pipeline purchaser, and accessibility to a market for his production is at the fancy of the pipeline purchaser (which may prefer to take the gas from the reservoir from another

well completed in the pool), then the operator is less likely to drill the well and less likely to obtain the necessary financing. The development of a state's natural resources is a legitimate local interest (Rule 48 is also in the national interest since it promotes the development of oil and gas).

The state's exercise of its police power in promoting conservation of its natural resources by preventing waste and protecting correlative rights has long been recognized as a legitimate state interest. *Cities Service Co. v. Peerless Oil and Gas Co.* 340 U.S. 179 (1950).

C. The Burden Imposed on Interstate Commerce is Not Clearly Excessive in Relation to the Local Putative Benefits.

Transco says that if it is forced to comply with Rule 48, it will have to either (1) take more Section 107 High Cost Gas than it needs from Mississippi, or (2) reduce its takes of said gas in Mississippi from its contract sellers thereby incurring take or pay costs. Neither choice will impose an excessive burden.

These proceedings which commenced in 1982, involve deregulated Section 107 High Cost Gas. In 1981, this category of gas represented only one percent of the aggregate supply of gas in the United States. Pierce, Natural Gas Regulation, Deregulation and Contracts, 68 Va.L.Rev. 63 (1982) at page 87-88). This tiny fraction of the aggregate gas supply will have no significant, let alone "excessive" impact. Furthermore, the days of excessive gas supply are just about over. Gas is an exhaustible resource. The oversupply in the past was dissipated by the 1970's when a shortage occurred. The deregulation which resulted from the NGPA in 1978 increased drilling and additional gas reserves were discovered which resulted in the current gas glut. However, the current gas glut is estimated to end by 1990. Johnston,

Natural Gas Sales Contracts, 34th Institute on Oil & Gas Law, Southwest Legal Foundation 83 at 112. The problems that Transco perceives are but temporary, and this should be considered in deciding whether Rule 48 creates an excessive burden.

The concerns of Transco are discussed in 3a and 3b below.

C(1), Does Rule 48 Require Transco to Take More Mississippi Gas?

Transco contends that the enforceability of Rule 48, when combined with Mississippi's policy of setting a well's allowable based upon deliverability, results in an increase in the percentage of gas taken from Mississippi at the expense of other producing states. The analysis is not correct. Allowables for gas wells are based upon deliverability under Rule 33 of the State Oil and Gas Board. But the allowable merely establishes the maximum rate that a well is allowed to produce. A producer is not required to produce a well at the allowable, he is only prevented from producing at a rate in excess of the allowable. All Rule 48 states is that if a purchaser takes production from one well, it must take production from other wells at the same rate (i.e. at the same percentage of the well's allowable whether it be one percent, fifty percent or one hundred percent of the well's allowable). The purpose of Rule 48 is to protect against drainage between wells resulting from unratable taking between wells.

There is nothing in Rule 48 or Order 409-82 which will require Transco to take any gas in the East Morgantown and Green Creek Fields in Mississippi. Transco can take no gas from these fields and comply with Rule 48. All Rule 48 says is that if Transco takes gas from one well in a pool, then it must take a like percentage of a well's allowable from the other wells in the pool. Transco has total control on the amount of gas it takes from a pool. Consequently, Rule 48

does not require Transco to increase its takes from Mississippi at the expense of other producing states.

C(2). Rule 48 Does Not Cause an Excessive Burden on Interstate Commerce Through Increased Take or Pay Costs.

Transco contends that if it is forced to take ratably and does not increase its total takes to cover non-contract owners' gas, then it will have to reduce purchases from owners with whom it has gas sales contracts. This reduction will cause Transco to make take or pay payments if purchases with these owners drop below the take or pay limit. If this happens the take or pay payments will not be an excessive burden on interstate.

1. First it should be stated that Rule 48 has nothing to do with contract obligations which parties may incur. All Rule 48 says is that if you purchase from one party then you must make a market available to the other parties in the pool. Any take or pay obligations which pipeline purchasers incur are obligations which the purchasers impose upon themselves and are not imposd by Rule 48. Accordingly, any alleged take or pay burdens should not be attributed to Rule 48.

2. Transco should not be permitted to relieve itself of contractual obligations which were of its own making by hiding behind the Commerce Clause. Transco was aware of Rule 48 when it purchased gas in Mississippi and was aware that it was subject to it:

By Chairman Fancher

Q: Okay. Let me ask you a question. When Transco enters into a gas purchase contract, are they aware of Rule 48?

(Ms. Pollard): Yes, sir when we contract to buy gas

in any state, we buy it subject to the rules in the state . . .

By Chairman Fancher

Q: Yes, that's all very good, but what about ratable take without discrimination? When you come in here to purchase gas, don't you realize that your contract is subject, and your purchasing and your distribution and sale of gas is subject to Rule 48? If the rule is any good it's part of your contract, isn't it? Or at least your operations are subject to it, are they not?

A: That's correct. J.A. 139-40

Furthermore, Transco was aware that from time to time excess supply conditions would exist since that is the only situation which would make a take or pay clause necessary or applicable. Transco should not be permitted to unilaterally relieve itself of contractual obligations by hiding behind the Commerce Clause. This Court has numerous times held that the Commerce Clause does not protect interstate firms from the impact of state regulation where the flow of interstate commerce is not affected. *Minnesota v. Clover Leaf Creamery, 449 U.S. 456 (1981); Exxon Corporation v. Governor of Maryland,* 437 U.S. 117 (1978).

3. Take or pay clauses are a benefit to interstate commerce rather than a burden because it facilitates oil and gas operations and marketing of gas. Take or pay provisions provide that if a purchaser does not take a certain quantity of gas by a particular date, then it must pay for that quantity; it will have the right to make up that quantity in the future with no additional cost. This clause meets the needs of both the producer and the purchaser:

> Thus the 'take or pay' provision meets the needs of the producer for a steady minimum income to pay his operating costs, taxes and royalty, while at the same time allowing the pipeline flexibility in the operation of its system to meet periods of uneven demand caused by weather, economic conditions, etc. The small producer frequently borrows money to finance his exploration and development programs on the security of income from his producing properties. If that income is disrupted through the shutting in of his wells for reasons over which he has no control, he may quickly find himself in serious financial difficulty. The take-or-pay provision provides important safeguards which allow such producers to stay in business.

Johnson, Natural Gas Contracts, 34 Annual Oil & Gas Institute, 83 at 111.

Any provision which is beneficial to both producer and seller and which facilitates exploration is a benefit and not a burden on interstate commerce.

4. Take or pay costs are paid by the pipeline purchaser. When the pipeline later makes up the gas it does not have to pay for it again. All the pipeline is out is the use of the money paid for gas not taken between the time the money is paid and the gas is made up. Assuming the use of money is worth ten percent, then the real cost is only ten percent of the take or pay payment. It is submitted that cost which is passed on to the consumer is a reasonable cost and but a "fraction of the cost paid by domestic consumers at the burner tips" and therefore, *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179 (1950) still applies.

5. Another reason that take or pay costs are reasonable is that take or pay costs are a necessary cost to obtain the gas. The gas contracts involved in this litigation were executed

during the gas shortage in the 1970-81 period. At that time Transco and other purchasers could not meet their customers needs. The seller was able to demand a high price for his gas and other contractual provisions such as take or pay clauses with high take requirements. The take or pay costs are part of the price necessary to obtain the gas and it is reasonable to pass it along to the consumer for whose benefit the gas was obtained. If those consumers will recall the hardships suffered during the gas shortage, they should be appreciative of what it took to obtain the gas. These costs were reasonable when the gas was acquired and passing these costs on to the consumer is a reasonable and not an excessive burden on interstate commerce. The Mississippi Court noted that higher purchasing costs at the wellhead leading to higher costs to the consumer is simply one inevitable consequence of the free market era of deregulation of the Commerce Clause. J.S. 38a.

6. Transco's argument that Statewide Rule 48 impermissably affects interstate commerce because it would result in higher prices to consumers is not determinative of the Commerce Clause question. First, higher prices to consumers in another state do not render a state's regulation of commerce impermissable under the Commerce Clause. *Cities Service Company v. Peerless Oil and Gas Co.*, 340 U.S. 179, 186-87 (1950). Secondly, Congress has declared that all reasonable costs of production of deregulated natural gas shall be borne ultimately by the consumer. This is one of the fundamental policy determinations underlying the Natural Gas Policy Act of 1978. *See, e.g. Public Service Commission v. Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983) (costs of providing production and incentives are plainly to be shouldered by down stream consumers, not pipelines). Thus, as pointed out by the Mississippi Supreme Court in its decision herein, "whether increased prices to consumers may be

fairly characterized as an incidental burden upon interstate commerce, we find it persuasive that Congress within the scope of its power under the affirmative Commerce Clause has expressly authorized its increases." J.S. 36a; *See also*, Steven Williams' article in 56 Univ. Colo. L.Rev 601, *supra*, (where he states that because of the NGPA's commitment to the ultimate establishment of a healthy competitive market at the wellhead, one may impute to Congress an intent that well-designed, market mimicking ratable take orders should now survive, notwithstanding some minor price burdens on consumers).

7. Moreover, the burdens on interstate commerce caused by Statewide Rule 48 as set forth by Transco are in reality, nothing but speculative and hypothetical examples of an imagined burden on interstate commerce, and such speculative and hypothetical possibilities are not sufficient to challenge a state regulation under the Commerce Clause. *Arkansas Electric Cooperative Corporation v. Arkansas Public Service Commission*, 461 U.S. 375 (1983). There is no proof in the record of actual burdens.

Based upon the foregoing, it is submitted that the take or pay obligations of Transco are not an unreasonable burden on interstate commerce.

D. Can the Burden be Promoted as Well With a Lesser Impact on Interstate Commerce?

Transco contends that Mississippi has a constitutional alternative to Rule 48 in that it can regulate the producer rather than the purchaser. This is not a practical solution. Mississippi can tell the producers to produce ratably, but if the pipeline won't take ratably, there will be no ratable production. The pipelines control production. Once gas comes out of the wellhead its only outlet is a pipeline to carry it to market. If a pipeline purchaser shuts its valve and does

not take a well's production, there is no way that well can produce without venting the gas into the atmosphere. The pipeline is the key player and must be subject to the Oil and Gas Board's jurisdiction to insure ratable taking.

Furthermore, as pointed out in the opinion of the Mississippi Supreme Court:

> The search for such alternatives, however, need not be made in connection with our Commerce Clause inquiry until it first be established that the regulation in question creates an unreasonable burden on commerce. This Transco has failed to do - for as explained above, the burdens are on Transco, not interstate pipelines generally, because only Transco has, wittingly or unwittingly, bound itself to a long term, fixed price gas purchase contract. When that contract is taken out of the case, it is seen that the so called burdens of Rule 48 disappear.

Transcontinental Gas Pipeline Corp. v. State Oil & Gas Board, 457 So.2d 1298, 1323 (Miss. 1984).

In summary, Transco has failed to show that the burden imposed upon interstate commerce by enforcement of Rule 48 is "clearly excessive in relation to the putative local benefits." Rule 48 is not in violation of the Commerce Clause. Attached as appendix A is a decision of the Oklahoma Corporation Commission which reaches the same result.

CONCLUSION

Rule 48 and Order No. 409-82 are fair and promote development of oil and gas in Mississippi. These are beneficial for the State of Mississippi and are consistent with national interests. The protection of the correlative rights of owners in oil and gas reservoirs applies to non-resident owners as well as resident owners. Oil and gas production benefits the nation as well as the states. Rule 48 does not produce the type of local prejudice that the Commerce Clause and the Supremacy Clause were designed to prevent.

Transco's claims and the authorities it cites arise from a past era when the nation's gas supply seemed inexhaustible. At that time it was possible to be concerned only with setting artificially low prices for consumers. The prevailing regulatory scheme at that time did not need to take into account what was necessary for a viable supply of gas and it did not. The shortsightedness of that regulatory policy resulted in decreased exploration and a shortage of gas supplies in the interstate market.

With the national gas shortage of the seventies the whole regulatory concept had to be reexamined. Congress realized that consideration had to be given to the supply side so that sufficient gas would be available to the national market. This was accomplished through deregulation as manifested in the Natural Gas Policy Act of 1978. With it came deregulation of first sales of Section 107 High Cost Gas, and also the realization that in order to obtain sufficient gas supplies the consumer would have to pay increased cost. This new policy brought the demise of old concepts of the Commerce Clause and preemption under the Supremacy Clause.

This case is a manifestation of the new era implemented by the NGPA. Rule 48 and orders implemented under it are viable and within all constitutional limits.

For these reasons, the judgment below should be affirmed.

Respectfully submitted,

Walker L. Watters
(Counsel of Record)
David T. Cobb
GERALD, BRAND, WATTERS, COX & HEMLEBEN
Post Office Box 158
Jackson, Mississippi 39205

Larry Port
Texaco, Inc.
Post Office Box 60252
New Orleans, Louisiana 70160

Attorneys For Getty Oil Company

APPENDIX

APPENDIX A

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

IN RE: WHETHER THE OKLAHOMA CORPORATION COMMISSION HAS THE AUTHORITY TO REQUIRE RATABLE TAKE OF NATURAL GAS BY FIRST PURCHASERS WHO ARE INTERSTATE PIPELINES.	**General Cause No. 28770** **Order No. 281285**

ORDER DETERMINING AUTHORITY OF THE COMMISSION TO REQUIRE RATABLE TAKES OF NATURAL GAS BY FIRST PURCHASERS WHO MAY BE INTERSTATE PIPELINES

I.
PROCEDURAL HISTORY

On January 9, 1984, the Oil and Gas Conservation Division of the Corporation Commission filed a Notice of Inquiry and Motion to Consolidate Causes as a result of numerous causes filed pursuant to 52 O.S. 1981, § 240, and rules promulgated thereunder. Exhibit "A" attached hereto and incorporated herein lists the pending causes. The Commission en banc heard oral argument on said motions and issued Order No. 254451 on February 27, 1984, which consolidated the causes and divided them into two phases, the first phase involving a review of Commission jurisdiction and the second phase to separate and continue any further proceedings on an individual case basis. In addition, Order No. 254451 set forth a briefing and oral argument schedule and established a hearing panel to take evidence and to consider the following issues common to the consolidated causes:

1. Is the State of Oklahoma preempted by the Commerce Clause of the United States Constitution from enforc-

ing the requirements of 52 O.S. 1981, § 240, requiring the ratable taking of gas against interstate pipelines which are the first purchasers of Oklahoma-produced natural gas?

2. Does the Federal Energy Regulatory Commission under the Natural Gas Act of 1938 and the Natural Gas Policy Act of 1978 have sole authority over the regulation of gas purchases by interstate purchasers of natural gas thereby preempting the State of Oklahoma from acting under 52 O.S. 1981, §§ 239 and 240?

Order No. 254451 was published as required by law and the rules of the Commission. Procedural directives regarding the filing of briefs, notices of intention to participate and scheduling of oral arguments were issued by the hearing panel on May 3, 1984, and May 17, 1984. Oral argument was had before the hearing panel on May 21, 1984, at which time all interested parties had an opportunity to present testimony. On September 4, 1984, the report of the hearing panel issued recommending that the issues presented to them be answered in the negative. The report was filed with the Secretary of the Commission on September 7, 1984. Exceptions and written comments were filed and oral argument was had before the Commission sitting en banc on October 17, 1984, at the close of which the cause was taken under advisement. By the filing of briefs or an entry of appearance or by an entry of appearance made at the time of oral argument, some 113 parties participated in this cause as listed on Exhibit "B" to this order. The parties will hereinafter be referred to as "Proponents" (those arguing in favor of Commission jurisdiction) and "Opponents" (those in opposition to Commission jurisdiction).

The Commission is aware that numerous authorities have been cited in support of each position and has addressed herein those most frequently cited or most supportive of the respective positions. All issues have been exhaustively briefed and argued and the Commission appreciates the efforts of all participants.

II.
OKLAHOMA STATUTORY SCHEME AND COMMISSION RULES PROMULGATED THEREUNDER

The focus of Commission inquiry in this matter is on 52 O.S. 1981, §§ 239 and 240 (hereinafter Section 239 and Section 240). These statutes were enacted in 1915 and have not been amended. Sections 239 and 240, provide as follows:

> SECTION 239. Whenever the full production from any common source of supply of natural gas in this state is in excess of the market demands, then any person, firm or corporation, having the right to drill into and produce gas from any such common source of supply, may take therefrom only such proportion of the natural gas that may be marketed without waste, as the natural flow of the well or wells owned or controlled by any such person, firm or corporation bears to the total natural flow of such common source of supply having due regard to the acreage drained by each well, so as to prevent any such person, firm or corporation securing any unfair proportion of the gas therefrom; provided, that the Corporation Commission may by proper order, permit the taking of a greater amount whenever it shall deem such taking reasonable or equitable. The said commission is authorized and directed to prescribe rules and regulations for the determination of the natural flow of any such well or wells, and to regulate the taking of natural gas from any or all such common sources of supply within the state, so as to prevent waste, protect the interests of the public, and of all those having a right to produce therefrom, and to prevent unreasonable discrimination in favor of any one such common source of supply as against another.
>
> SECTION 240. Every person, firm or corporation, now or hereafter engaged in the business of purchasing and selling natural gas in this state, shall be a common purchaser thereof, and shall purchase all of the natural gas which may be offered for sale, and which may reasonably be

reached by its trunk lines, or gathering lines without discrimination in favor of one producer as against another, or in favor of any one source of supply as against another save as authorized by the Corporation Commission after due notice and hearing; but if any such person, firm or corporation, shall be unable to purchase all the gas so offered, then it shall purchase natural gas from each producer ratably. It shall be unlawful for any such common purchaser to discriminate between like grades and pressures of natural gas, or in favor of its own production in which it may be directly or indirectly interested, either in whole or in part, but for the purpose of prorating the natural gas to be marketed, such production shall be treated in like manner as that of any other producer or person, and shall be taken only in the ratable proportion that such production bears to the total production available for marketing. The Corporation Commission shall have authority to make regulations for the delivery, metering and equitable purchasing and taking of all such gas and shall have authority to relieve any such common purchaser, after due notice and hearing, from the duty of purchasing gas of an inferior quality or grade.

On October 19, 1983, this Commission promulgated rules pursuant to these sections, effective January 1, 1984, which established a priority schedule for takes of natural gas where a supply and demand imbalance is present within a first purchaser's system within the State of Oklahoma. At the hearing before the panel of hearing officers on May 21, 1984, the panel ruled that reference could be made to the "Priority Rules" within the context of arguments on the constitutional issues since the priority rules (1) are an example of the type of authority the Commission seeks to assert over interstate pipelines; (2) were promulgated under the authority of Sections 239 and 240, which statutes are here the subject of constitutional inquiry; and (3) are final and unappealable. A copy of the final rules is attached hereto as Exhibit "C" and incorporated herein.

III.
ARGUMENTS AND AUTHORITIES

Is the State of Oklahoma Preempted by the Commerce Clause of the United States Constitution from Enforcing the Requirements of 52 O.S. 1981, § 240, Requiring the Ratable Taking of Gas Against Interstate Pipelines Which are the First Purchaser of Oklahoma-Produced Natural Gas?

Opponents argue that Commission regulation of pipeline takes will impermissibly burden interstate commerce for the reasons that prices of natural gas will increase, costs of administration, construction, and operation will increase and contractual obligations will be impaired. Further, opponents believe that these statutes are discriminatory and protectionist in nature which are prohibited by the Commerce Clause, relying primarily on *Hughes v. Oklahoma*, 441 U.S. 322 (1979); *Philadelphia v. N.J.*, 437 U.S. 617 (1978); *H. P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525 (1949); *Tenneco, Inc. v. Sutton*, 530 F. Supp. 411 (D.C. La. 1981); and *Federal Power Commission v. Oklahoma Corporation Commission*, 362 F.Supp 522 (W.D. Okl. 1973), aff'd, 415 U.S. 961 (1974). In *Hughes v. Oklahoma*, *supra*, the Supreme Court found an Oklahoma statute which provided that no person could "transport or ship [minnows] . . . for sale outside the state" violative of the Commerce Clause for the reason that the statute on its face discriminated against interstate commerce and that a legitimate local purpose was not ascertainable, reversing a previous position concerning wild animals and fish. 441 U.S. at 335-339. Likewise, a New Jersey statute prohibiting the importation of "solid or liquid waste which originated or was collected outside the territorial limits of the state . . ." was held to be violative of the Commerce Clause in *Philadelphia v. N.J.*, *supra*, for its discriminatory effect and its attempt to protect the State from the common problem of waste. 437 U.S. at 618. In *H.P. Hood & Sons v. Dumond*, *supra*, the Court found that a New York statute as applied to the licensing of milk distributors was

offensive to the Commerce Clause in that the purpose was to promote the State's economic advantage by curtailing interstate commerce. In *Tenneco v. Sutton, supra*, the Court found, inter alia, that Louisiana's statutes and regulations governing the offer to purchase gas by local users before it is offered to interstate users was clearly economic protectionism with no legitimate local purpose. 530 F. Supp. at 440. Finally, an Order by the Oklahoma Corporation Commission setting a minimum price level for natural gas was found to be protectionist in *Federal Power Commission v. Corporation Commission, supra*, as the purpose was not to prevent waste or protect correlative rights. 362 F. Supp. at 538. These cases clearly establish that a legitimate local interest must be the basis for a nondiscriminatory statute that effects interstate commerce and that such interest must outweigh any burden placed on interstate commerce.

Proponents argue that the exercise of state regulation over pipeline takes is constitutionally permissible in that the impact on interstate commerce is merely incidental. In addition, it is argued that the Oklahoma ratable take provisions are essentially directed toward the production of natural gas, an activity that is not considered interstate commerce. Finally, reliance is placed on *Cities Service Gas Company v. Peerless Oil and Gas Company*, 340 U.S. 197 (1950), (hereinafter "*Peerless*") in which the United States Supreme Court held that orders of the Oklahoma Corporation Commission setting natural gas prices and directing an interstate pipeline to make a well connection and take ratably pursuant to Section 240 did not impermissibly burden interstate commerce.

DISCUSSION

All parties agree that the general test for determining whether or not a state statute impermissibly impacts interstate commerce has been set forth in *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970), wherein the United States Supreme Court stated:

> Although the criteria for determining the validity of state statutes affecting interstate commerce have been variously stated, the general rule that emerges can be phrased as follows: Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. *Huron Cement Co. v. City of Detroit*, 362 U.S. 440, 443, 80 S.Ct. 813, 816, 4 L.Ed.2d 852. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

With regard to the first prong of the test under *Pike*, whether the statute is discriminatory, a plain reading of Section 240 demonstrates that all pipelines are subject to its terms "[w]henever the full production from any common source of supply of natural gas in this state is in excess of the market demands . . . " Section 239. It must be emphasized that Section 240 does not stand alone in its application; that it must be read in conjunction with Section 239 as a means for accomplishing the state's objective.

Section 239 sets forth circumstances for the allocation and regulation of the production of natural gas when supply exceeds demand. In addition to regulating the flow of production, another means for accomplishing the objectives explicitly authorized by Section 239 is to regulate the taking of natural gas from a common source of supply. The latter method of regulating production is more fully discussed in Section 240 which provides guidelines for the regulation of takes. The Commission's exercise of jurisdiction over interstate pipelines is therefore incidental to its jurisdictional mandate to regulate production pursuant to Section 239 and a tool for enforcing such production regulation.

The next prong of the test to determine whether these state statutes contravene the Commerce Clause is to identify a "legitimate local public interest" to which the regulation is directed. The state's exercise of its police power in promoting conservation of its natural resources by preventing waste and protecting correlative rights has long been recognized as a legitimate state interest. *See, generally, Peerless*, ("That a legitimate local interest is at stake in this case is clear. A state is justifiably concerned with preventing rapid and uneconomic dissipation of one of its chief natural resources.") 340 U.S. at 187; *Champlin Refining Co. v. Corporation Commission*, ("In Oklahoma, as generally elsewhere, landowners do not have absolute title to the gas and oil that may permeate the surface. These minerals, differing from solids in place such as coal and iron, are fugacious and of uncertain movement within the units of the pool. Every person has the right to drill wells on his own land and take from the pools below all the oil and gas that he may be able to reduce to possession including that coming from land belonging to others, but the right to take and thus acquire ownership is subject to the reasonable exertion of the power of the State to prevent unnecessary loss, destruction, or waste and that power extends to the taker's unreasonable and wasteful use of natural gas pressure available for lifting oil to the surface and the unreasonable and wasteful depletion of a common supply of gas and oil to the injury of others entitled to resort to and take from the same pool." [citations omitted]) 286 U.S. 210 at 233-234 (1932); *Walls v. Midland Carbon Co.*, ("The determining consideration is the power of the state over, and its regulation of, a property in which others besides the companies may have rights and in which the state has an interest to adjust and preserve, natural gas being one of the resources of the state. And this consideration it is more important to consider not for what a particular owner uses the gas, but the proportion of his use to that of others; or it may be, the prevention of use by others;") 254 U.S. 300 at 319 (1920).

Having established a legitimate local interest, the remaining prong of the *Pike* test focuses on the degree of burden which is

placed on interstate commerce by the state regulation. It is contended by some proponents that a producer's ability and right to produce gas always has an incidental effect on the purchaser's takes. Likewise, the supervision of those takes as a necessary means of regulating production incidentally affects interstate commerce. However, opponents believe that the burden of complying with Oklahoma's ratable take requirements directly interferes with interstate commerce.

In response to these contentions, and in support of Commission jurisdiction, proponents note that interstate pipelines presently maintain records and conduct operations in conformity with special allocated gas pool field-wide rules similar to what would be required for compliance with prorated takes. While opponents appear to speculate as to imagined burdens of costs and operational responsibilities, one interstate pipeline represented that it had adopted on its own initiative a ratable take procedure which has not burdened the company nor interstate commerce.

Opponents also allege that natural gas prices will increase as a result of increased construction and operational costs as well as contractual liabilities and obligations, thereby burdening interstate commerce. It is noted that the Commission has always had jurisdictional supervision over the construction and operation of gathering lines of interstate pipelines pursuant to the Natural Gas Act of 1938 (hereinafter NGA). In fact, the Federal Energy Regulatory Commission (hereinafter FERC) has formulated various tests to apply to pipelines in determining whether they are subject to the jurisdiction of the NGA. *See, e.g., Phillips Petroleum Company,* 10 FPC 246, 277 (1951), rev. on other grounds, 347 U.S. 672 (1954) ("behind the plant" theory); *Barnes Transportation, Inc.*, Opinion No. 306, 18 FPC 369 (1957) ("central point test") and *Ben Bolt Gathering Compamy,* 26 FPC 825 (1961), aff'd., 323 F.2d 610 (5th Cir. 1963) ("primary function" test). If exempted pursuant to Section 1(b) of the NGA, 15 U.S.C. § 717(b), this Commission may exercise its jurisdiction over the construction and operation of

the pipeline. Of course, any proposed construction or service of an interstate pipeline would require certificated approval by the FERC prior to the commencement where the costs would be subject to scrutiny as to their reasonableness by that agency. The Commission is unpersuaded that the speculative costs constitute an impermissible burden as companies are often required to expend large sums of money to comply with governmental regulations.

Opponents also contend a burden is placed on interstate commerce by the possibility that an interstate pipeline may incur contractual liabilities ("take or pay" obligations) as a result of state regulation. It is also argued that a pipeline's average cost of gas will be increased for the reason that the price of noncontractual parties' gas will be higher, thereby burdening interstate commerce. Proponents counter argue that any contractual liability would be suspended and superseded by state law, thereby alleviating any direct burden on interstate commerce. Proponents also contend that the cost of gas is not an issue as the NGPA has statutorily set price ceilings on natural gas or deregulated certain categories, requiring the FERC to investigate only those circumstances involving misrepresentation of the price paid or abuse rising to the level of "reckless disregard" in its ratemaking practices. Further, it is asserted by proponents that pipelines would not be required to take gas in excess of their market demand as contended and would, indeed, have flexibility in their purchase patterns as reflected in the priority schedule of Rule 1-305, Exhibit "C", attached hereto.

The Commission recognizes that some interstate pipelines are presently exposed to liability under existing contractual obligations and that this liability is frequently at issue in pipeline rate cases and rulemakings before FERC, in state and federal courts and in private settlement discussions. The Commission is reluctant, however, to project an economic scenario based on hypothetical fears on which to rest its decision. Rather, the Commission is of the opinion that it is, in fact,

exercising incidental jurisdiction over takes of gas while regulating production and furthering the legitimate state interest in protecting correlative rights and preventing waste. When applying the *Pike* test to the instant situation, it appears the weight of the scales is toward the exercise of the state's police power over production and enforcement thereof through the prorationing of takes. There is no method of promoting the state's interest which would have a lesser impact on interstate activities and to conclude otherwise would subject the state's power to protect its interest to that of private contracting practices.

Opponents' contention that these statutes are protectionist in nature must be rejected as there is no evidence that this state is placed in a position of economic isolation, enhancing its economy while depriving a sister state of economic benefits. The United States Supreme Court has noted that ". . . a state law constitutes 'economic protectionism' on proof either of discriminatory effect, *see Philadelphia v. New Jersey*, or of discriminatory purpose, *see Hunt v. Washington Apple Advertising Comm'n*, 432 U.S., at 352-353", *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456 at 471 (1981). The record contains no evidence of either situation. Indeed, the statutes apply to both interstate and intrastate pipelines which precludes claims of discrimination and protectionism.

Proponents also rely on the *Peerless* decision as being persuasive in light of the Court's consideration of the Commerce Clause challenge to Sections 239 and 240. We are mindful that the Court's analysis of the State's order setting prices is no longer valid under *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), but believe that the Court's analysis of the state's conservation measures as determined by the Legislature in enacting Sections 239 and 240 is precedential.

In *Peerless*, the Supreme Court reviewed the Oklahoma statutory scheme and agreed with the Oklahoma Supreme Court that Sections 239 and 240 did not violate the Commerce Clause of the Federal Constitution. 340 U.S. at 184-185. It

recognized that ". . . a state may; adopt reasonable regulations to prevent economic and physical waste of natural gas," noting that "[t]his Court has upheld numerous kinds of state legislation designed to curb waste of natural resources and to protect the correlative rights of owners through ratable taking (citations omitted)." 340 U.S. at 185. The Supreme Court's consideration and constitutional pronouncement regarding the Oklahoma statute does lend support for its validity.

And, finally, proponents contend that the proposed regulation is an incident of production and not part of interstate commerce. *See, Champlin Refining Co. v. Corporation Commission, supra* at 236. While opponents disagree, it seems only logical that when production is dictated by pipeline capacity and demand and limited by this agency's setting of an allowable, the pipeline must be an integral part of that production function and regulation. Section 239 sets forth the circumstances under which prorating occurs and Section 240 provides a means of enforcing proration requirements. In this regard, the exercise of jurisdiction over interstate pipelines is incidental to this Commission's statutory responsibilities to protect correlative rights and prevent waste, a function of the regulation of production. As such, any incidental effect on interstate pipelines and interstate commerce is permissible.

IV.
ARGUMENTS AND AUTHORITIES

Does The Federal Energy Regulatory Commission Under The Natural Gas Act Of 1938 And The Natural Gas Policy Act Of 1978 ("NGPA") Have Sole Authority Over The Regulation Of Gas Purchases By Interstate Purchasers Of Natural Gas Thereby Preempting The State Of Oklahoma From Acting Under 52 O.S. 1981, §§ 239 And 240.

Opponents contend that the regulation of pipeline takes interferes with the regulatory scheme established by the NGA and NGPA which is administered by the FERC. In particular, it is alleged that state regulation of pipeline takes is prohibited

in that the FERC has exclusive jurisdiction over the sale and transportation of natural gas. It is contended that requiring ratable takes by pipelines would affect the price of that gas and certificated services which jurisdiction is exclusively that of the FERC. Reliance is placed on *Northern Natural Gas Co. v. State Corporation Commission of the State of Kansas*, 372 U.S. 84 (1963), (hereinafter "*Northern Natural*") in which the United States Supreme Court held as void an order of the Kansas Corporation Commission requiring a gas pipeline purchaser to take ratably from all producers supplying it with gas from a common source of supply. Other authorities which opponents cite to support their preemptive view are *Public Service Commission of the State of New York v. Mid-Louisiana Gas Company*, 463 U.S. 319, (1983); *Exxon Corporation v. Eagerton*, 462 U.S. 176 (1983); *Maryland v. Louisiana*, 451 U.S. 725, (1981); *California v. Southland Royalty Company*, 436 U.S. 519, (1978); *Tenneco, Inc. v. Sutton, supra.*

Public Service Commission of the State of New York v. Mid-Louisiana Gas Company, supra, involved a review of two orders promulgated by the FERC. The first order defined "first sale" pursuant to the NGPA as applied solely to interstate pipeline sales of natural gas and commingled independent-producer and pipeline-producer gas sales. The second order promulgated regulations under the NGA setting prices for pipeline production. The Supreme Court reviewed the natural gas regulatory pricing history and philosophy finding that:

> The NGPA is designed to preserve the Commission's authority under the NGA to regulate natural gas sales from pipelines to their customers; however, it is designed to supplant the Commission's authority to establish rates for the wholesale market, the market consisting of so-called "first sales" of natural gas. 463 U.S. at 331.

After a review of NGPA provisions and congressional intent, the Court concluded that the FERC orders pricing pipeline production differently than other production were "inconsistent with the statutory mandate (and would) frustrate the

policy that Congress sought to implement." [citation omitted]. This case is instructive insofar as explaining the effect of the NGPA on the first sale of natural gas.

An Alabama statute which prohibited oil and gas producers from passing through severance tax increases to purchasers was held preempted by federal law as to the sale of gas in interstate commerce in *Exxon Corporation v. Eagerton, supra*. The statute also prohibited producers from passing the 2% tax increase through to consumers and exempted royalty owners from the percentage tax increase which the Court found permissible under the NGPA. This case illustrates the limitation of a state's direct imposition of price regulation on interstate commerce versus its ability to regulate the intrastate market. Likewise when Louisiana imposed a "first use" tax on gas imported into the State from principally the Outer Continental Shelf, the Supreme Court held the law unconstitutional as violative of the Supremacy and Commerce Clauses. *Maryland v. Louisiana, supra*. After considering various procedural aspects, the Court found that "the effect of § 1303C (part of First-Use Tax) is to interfere with the FERC's authority to regulate the determination of the proper allocation of costs associated with the sale of natural gas to consumers." 451 U.S. at 749. The Court's concern was that the one effect of the tax was to preclude FERC approval of expenses. 451 U.S. 750.

California v. Southland Royalty Company, supra, upheld a Federal Power Commission ("FPC," predecessor to FERC) order which found that gas dedicated to interstate commerce could not be diverted to the intrastate market without authorization of abandonment of service. This case was decided without consideration of the NGPA, but is a good review of the FPC's jurisdiction under the NGA. However, the exclusive authority of the FERC to regulate certificated service is not in question in this matter—only the ability of the state to regulate production through prorationing of takes.

The Louisiana statutes granting preferential treatment to Louisiana users and consumers were found to be preempted by

the NGA and NGPA in *Tenneco, Inc. v. Sutton, supra*, for the reasons that there was a direct conflict with federal statutory provisions and the purposes and objectives of the NGPA and NGA were frustrated. 530 F. Supp. at 437-438. This conclusion was reached after a consideration of the congressional histories of the federal acts and an extensive review of the caselaw. Opponents' authorities support the proposition that direct regulation of the transportation and sale of natural gas in interstate commerce is impermissible. However, it is contended that the Oklahoma statutory scheme does not directly regulate these areas.

Proponents assert that Oklahoma's ratable take statutes are directed toward the "production or gathering of natural gas" within the 1(b) exemption of the NGA, 15 U.S.C. § 717(b), and not to the transportation or sale of natural gas. Further, proponents contend that the passage of the NGPA has increased state regulation of oil and gas and eliminated any previously existing federal preemption. They further contend that the holding in *Northern Natural* has been eroded in light of the passage of the NGPA and that state and federal regulation of different aspects of an interstate pipeline in permissible. Support for these positions is primarily placed on *Public Service Commission of New York v. Mid-Louisiana Gas Co.*, discussed *supra; Tenneco, Inc. v. Sutton*, discussed *supra; Penzoil Company et al. v. FERC*, 645 F.2d 36 (5th Cir. 1981); *Mobil Oil Exploration and Producing Southeast, Inc.*, FERC Docket No. CI 77-41000, 18 FERC § 61,266 (1982).

The Court in *Penzoil Co. v. F.E.R.C., supra*, addressed the issue "[m]ay 'area rate clauses' in existing interstate gas purchase contracts escalate the contract price to the maximum lawful price provided in the Natural Gas Policy Act of 1978?" 645 F.2d at 365. The Court reviewed the NGPA and the Commission's responsibilities thereunder and upheld the FERC's orders permitting price escalation. Proponents have cited this case in support of their position that the NGPA has altered the regulatory outlook of the FERC.

Of particular interest is *Mobil Oil Exploration and Producing Southeast, Inc., supra*, in which the FERC reviewed relevant caselaw and commented on the agency's position concerning the 'production and gathering exemption', concluding:

> [I]t is clear that the production and gathering extends to the physical activities and processes involved in producing and gathering gas, as well as to the properties and facilities used in production and gathering. Congress left to the states the power to regulate these areas in order that the states could further their own legitimate interests in such matters as the conservation of their natural resource supplies, the prevention of waste, the economical and efficient development of their mineral resources, and the protection of the correlative rights of individual mineral interest owners. 18 FERC § 61,266.

In determining whether a state law is preempted by federal law, one must "start with the assumption that the historic police powers of the states were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977), quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). Thus, where Congress explicitly states its intention to preempt state regulation in a specific area, or a "scheme of federal regulation [is] so pervasive as to make reasonable the inference that Congress left no room for the states to supplement it," state regulation is barred. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. at 230. A review of the federal regulatory scheme demonstrates no express prohibition against state regulation of gas purchased by interstate pipelines as an incident of discharging the state's recognized interest in regulating production. It is also believed that the exercise of state and federal jurisdiction can coexist and work harmoniously as different aspects of the pipeline's business activities are regulated. The primary objective in resolving preemption issues is to attempt to accommodate state and federal interests. A re-

view of the federal regulatory framework should assist this analysis.

The NGA conferred authority on the FPC to regulate natural gas companies engaged in the construction of facilities and transportation and sales of natural gas in interstate commerce. FPC jurisdiction was expanded to include regulation of producer sales to pipelines of natural gas prices pursuant to *Phillips Petroleum Company v. Wisconsin, supra.* Congress expressly provided that the NGA would not apply to "any other transportation or sale of natural gas or to local distribution of natural gas or to the facilities used for such distribution or to the production and gathering of natural gas." 15 U.S.C. § 717(b). Therefore, federal jurisdiction under the NGA and *Phillips* was primarily directed toward the construction of facilities and transportation, sale and price of natural gas. As a result of a bifurcated gas market and inadequate interstate supply of gas, Congress enacted the NGPA which categorized natural gas and established a statutory maximum lawful price for certain categories, while deregulating others. *See, Tenneco, Inc. v. Sutton, supra,* at pages 418-420, for an overview of the NGPA. The establishment of statutory rates had the effect of supplanting FERC's "authority to establish rates for the wholesale market." *Public Service Commission of the State of New York v. Mid-Louisiana Gas Company, supra,* at 331. The statutory price paid for natural gas is deemed just and reasonable. *See,* 15 U.S.C. § 343 1(b)(1)(A); *Public Service Commission of New York v. Mid-Louisiana Gas Co., supra,* at 334.

While it is clear that the establishment of just and reasonable rates over the construction and transportation of natural gas and sale to its customers by interstate pipelines is an exclusive area reserved to the FERC, it is certain that Congress did not intended FERC to regulate production through requiring ratable takes by pipelines. Although the Court in *Northern Natural* explicitly rejected the application of the "production and gathering" exemption to those set of facts, the invalidation of Kansas' common purchaser statutes rested on other grounds.

One learned commentator has suggested that the Court was primarily concerned with the effect that the ratable take order could have on the price of gas to the consumer as "the fundamental purpose of FPC jurisdiction to regulate the sale of gas at the wellhead is to control prices for the benefit of the ultimate consumer." Meyers, "Federal Preemption and State Conservation in Northern Natural Gas," 77 Harvard Law Review 689 at 696 (1964). As proponents have pointed out, the federal regulatory focus has shifted from consumer protection to establishing price incentives for the exploration and development of natural gas reserves. In addition, the issue in *Northern Natural* was not whether the state had the power to regulate, but whether "the particular means chosen . . . threaten effectuation of the federal regulatory scheme." *Northern Natural, supra,* at 93. *Northern Natural's* precedential value is therefore questionable in light of the passage of the NGPA.

However, preemption may also be inferred when "compliance with both federal and state regulations is a physical impossibility." *Florida Lime and Avocado Growers v. Paul,* 373 U.S. 132, 142-143 (1963). Opponents complain that compliance would be burdensome and that there may be conflicts with certificated service, but the circumstances here do not reveal that compliance with the federal and state requirements would be a "physical impossibility." Both the state and federal regulatory schemes contemplate the exercise of independent business judgment by the regulated in managing their business while complying with the applicable laws. Any hypothetical conflict of state and federal law can either be avoided by prudent management or encouraged by deliberate actions. However, the Commission believes that proper planning in the decision-making process of this regulated industry will result in the accommodation of all interests.

And, finally, "preemption of a state statute may be found when that statute stands as an obstacle to the accomplishment of the full purposes and objects of Congress." *Jones v. Rath Packing Co.,* 430 U.S. at 526, 540-41, quoting *Hines v.*

Davidowitz, 312 U.S. 52, at 67 (1941). It is claimed that the Oklahoma statute intrudes upon the exlusive federal jurisdiction over interstate pipelines and their practices, but this proposition must be rejected. The FERC's responsibility to determin just and reasonable prices over the "first sale" of natural gas has been replaced by categorical price ceilings on natural gas. Congressional objectives have changed since the passage of the NGPA to encourage exploration for, and development of, natural gas reserves. In this regard, the Oklahoma statutes complement the federal objective as they attempt to prevent waste, thus preserving natural gas for the future.

The Oklahoma Supreme Court has stated on several occasions that this Commission "may employ such means as may be reasonably necessary to accomplish the declared purposes" of Section 239. *See, Corporation Commission v. Phillips Petroleum Company*, 536 P.2d 1284 (Okl. 1975); *Choctaw Gas Company v. Corporation Commission*, 295 P.2d 800 (Okl. 1956). The establishment of priority rules and enforcement of ratable take provisions of Sections 239 and 240 are a reasonable means of protecting correlative rights and preventing waste while regulating the production of natural gas from a common source of supply. Together, these statutes provide a legitimate means for fulfilling the state's objectives in preserving its natural gas reserves and protecting the correlative rights of those with an interest in the reserves.

FINDINGS

1. The regulation of natural gas takes by interstate pipelines is an incident of the exercise of this Commission's jurisdiction over the regulation of the production of natural gas from a common source of supply. The exercise of this incidental jurisdiction is necessary in order to protect correlative rights and prevent waste.

2. Sections 239 and 240 and the regulations promulgated thereunder attempt to accommodate interests of both producer and pipeline by adjusting production of natural gas to demand

thereof. The state's interest is furthered by this method by ensuring that production is uniform throughout the common source of supply, protecting against drainage, thus, protecting the correlative rights of all owners of an interest in the natural gas. Any effect such regulation has on interstate commerce is minimal.

3. Commission regulatory jurisdiction over pipeline takes does not encroach upon the jurisdiction of the FERC under the NGA and NGPA. The FERC is not vested with jurisdiction over the production and gathering of gas which is essentially the function of Sections 239 and 240 and the regulations promulgated thereunder.

4. Oklahoma enacted its common carrier and ratable take statutes prior to federal regulation of inerstate pipelines. That regulation of natural gas pipelines by the FERC has changed over the years and again is in the process of significantly changing. This Commission's exercise of incidental jurisdiction is not offensive to the proposed federal regulation. *See, generally, Notice of Proposed Rulemaking,* Regulation of Natural Gas Pipelines After Partial Wellhead Decentral, Docket No. RM85-1-000 (Parts A-D) (Issued May 30, 1985). In light of the present regulatory atmosphere this Commission's jurisdiction can co-exist with and complement that of the FERC.

ORDER

The Commission has reviewed the pleadings filed in this matter and considered all arguments and makes the following determinations:

1. The Commerce Clause of the United States Constitution does not prohibit the enforcement of 52 O.S. § 240 requiring taking of gas against interstate pipelines which are the first purchaser of Oklahoma produced natural gas.

2. The FERC does not have sole authority under the NGA and NGPA over the regulation of gas purchases by interstate

purchasers of natural gas thereby preempting the State of Oklahoma from acting under 52 O.S. § § 239 and 240.

3. The pending causes are hereby directed to proceed on their individual merits.

CORPORATION COMMISSION OF OKLAHOMA

JAMES B. TOWNSEND, Chairman

NORMA EAGLETON, Vice-Chairman.

HAMP BAKER, Commissioner

DONE AND PERFORMED this 3 day of JULY, 1985.

BY ORDER OF THE COMMISSION:

BERDEE S. HOLT, Secretary

GGS/ar

(13)

Office-Supreme Court, U.S.
FILED
JUL 18 1985
ALEXANDER L. STEVAS,
CLERK

No. 84-1076

In the Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,

Appellant,

vs.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., ET AL.,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF MISSISSIPPI

BRIEF FOR THE APPELLEE THE STATE OIL & GAS BOARD OF MISSISSIPPI

EDWIN LLOYD PITTMAN, Attorney General
State of Mississippi
ED DAVIS NOBLE, JR.
Assistant Attorney General
(Counsel of Record)
R. LLOYD ARNOLD
Assistant Attorney General
Post Office Box 220
Jackson, Mississippi 39205
(601) 359-3680

Attorneys for the State Oil and Gas Board of Mississippi

E. L. MENDENHALL, INC., 926 Cherry Street, Kansas City, Mo. 64106, (816) 421-3030

BEST AVAILABLE COPY

2017

QUESTIONS PRESENTED

I.

When the price of certain natural resources was deregulated as provided by the Natural Gas Policy Act of 1978, 15 U.S.C. § 3431(a)(1)(B)(i), did the Mississippi Oil and Gas Board have the authority to impose its Regulations (Rule 48) to prevent waste and drainage and to protect the rights of the correlative owners in a designated pool or source of supply.

II.

Whether the "ratable take" provisions of Rule 48 of the State Oil and Gas Board of Mississippi creates an impermissible burden on interstate commerce, or alternatively, whether pursuant to the balancing of interests test announced in *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), the State may reasonably regulate the allocation of its natural resources to prevent waste and drainage.

TABLE OF CONTENTS

QUESTIONS PRESENTED I

BRIEF FOR THE APPELLEE, THE STATE OIL AND GAS BOARD OF MISSISSIPPI 1

SUMMARY OF THE ARGUMENT 5

ARGUMENT 7

I. When the Price of Certain Natural Resources Was Deregulated As Provided by the Natural Gas Policy Act of 1978, 15 U.S.C. § 3431(a)(1)(B)(i), the Congress Ceded to the States, and in This Instance Mississippi, the Authority to Impose Its Regulations (Rule 48) to Prevent Waste and Drainage and to Protect the Rights of the Correlative Owners, Operators or Producers in a Designated Pool and/or Drilling Unit 7

II. The "Ratable Take" Provision of Rule 48 of the Oil and Gas Board of Mississippi Does Not Impede Interstate Commerce Because Its Operation Is Reasonably Calculated to Protect a "Legitimate Local Interest" - Fairness, That Is, to Insure an Appropriate Share for Each Correlative Owner, Operator or Producer 12

CONCLUSION 15

TABLE OF AUTHORITIES

Cases

Black v. Cutter Laboratories, 351 U.S. 292, 76 S.Ct. 824, 100 L.Ed. 1188 (1956) 8

California Company v. State Oil and Gas Board, 200 Miss. 824, 27 So.2d 542 (1946) 1

Energy Reserves Group, Inc. v. Kansas Power & Light Company, 459 U.S. 400, 419, 102 S.Ct. 697, 74 L.Ed.2d 569, 586 (1983) 14

Hillsborough County, Fla. v. Automated Medical Laboratories, Inc. ..... U.S. ..... (No. 83-1925, 53 U.S.L.W. 4612, June 3, 1985) 6, 11, 12

Metropolitan Life Insurance Co. v. Commonwealth of Massachusetts, ... U.S. ..... (Nos. 84-325 and 84-326, 53 U.S.L.W. 4616, June 3, 1985) 6, 12

Mississippi University for Women v. Hogan, 458 U.S. 718, 723, 102 S.Ct. 331, 78 L.Ed.2d 1090 (1984) 8

Northern Natural Gas Co. v. State Corporation Commission of Kansas, 372 U.S. 84, 83 S.Ct. 646, 9 L.Ed.2d 601 (1963) 6

Ohio Oil Co. v. Indiana, 177 U.S. 190, 202-211, 10 S.Ct. ....., 44 L.Ed. 729, 736-740 (1900) 5, 13

Phillips Petroleum Co. v. Oklahoma, 340 U.S. 190, 192, 71 S.Ct. 221, 222, 95 L.Ed. 204, 205-206 (1950) 5

Pike v. Bruce Church, Inc., 397 U.S. 137, 90 S.Ct. 844, 25 L.Ed.2d 174 (1970) .....I, 4, 5, 7, 12

Transcontinental Gas Pipeline v. State Oil and Gas Board, 457 So.2d 1298 (1984) 3, 4, 7, 8, 13, 14

Other Authorities

15 U.S.C. § 3431(a)(1)(B)(i) 1, 6, 15
15 U.S.C. § 3431(c) 7, 15
15 U.S.C. § 3317(c)(1) 2, 4, 6, 8, 15
Chapter 117, §§ 1-48, Mississippi Laws of 1932 1
Chapter 256, Mississippi Laws of 1948, § 53-1-5, Mississippi Code of 1972 (Supp. 1983) 1
Chapter 301, Mississippi Laws of 1970, § 53-1-17, Mississippi Code of 1972 2
Chapter 365, Mississippi Laws of 1972, § 53-3-101, *et seq.*, Mississippi Code of 1972 (Supp. 1984) 2
§ 53-1-39, Mississippi Code of 1972 4

No. 84-1076

In the Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,

Appellant,

vs.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., ET AL.,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF MISSISSIPPI

BRIEF FOR THE APPELLEE THE STATE OIL & GAS BOARD OF MISSISSIPPI

The Mississippi Legislature established the State Oil and Gas Board (the Board) in 1932 to aid in the conservation of natural resources and to encourage their development. Chapter 117 §§ 1-48, Miss. Laws of 1932. Although the Board had the authority to enforce well-spacing provisions, *California Company v. State Oil and Gas Board*, 200 Miss. 824, 27 So.2d 542 (1946), it was not until 1948 that it possessed the power to force nonconsenting owners into units of sufficient size to allow proper development. In 1948 the Legislature enacted a compulsory pooling law giving the Oil and Gas Board the power to integrate tracts into drilling units. Chapter 256, Mississippi Laws of 1948, § 53-1-5, Miss. Code of 1972 (Supp. 1983). Through successive legislation, the Board is cur-

rently vested with compulsory unitization powers, that is, to specify and recognize a common pool or source of supply in an oil and gas field. Chapter 365, Mississippi Laws of 1972, § 53-3-101, *et seq.*, Miss. Code of 1972 (Supp. 1984).

Consistent with its legislative mandates, the Oil and Gas Board of Mississippi is authorized to institute and enforce reasonable rules, regulations and orders to protect the established interests and correlative rights of the recognized owners of oil and gas in a common source of supply. In recognition of its responsibility to protect the interests and rights of *all* participants in a common unit, Chapter 301, Miss. Laws of 1970, § 53-1-17, Miss. Code of 1972, Rule 48 was issued by the Board in conformity with this mandate on November 19, 1951:

> Rule 48 Ratable Take.
>
> Each person now or hereafter engaged in the business of purchasing oil and gas from owners, operators or producers shall purchase without discrimination in favor of one owner, operator or producer against another in the same common source of supply.

"Rule 48" remained unchallenged for thirty (30) plus years. The fairness doctrine explicit in the rule was universally accepted. Pursuant to the Natural Gas Policy Act of 1978 (NGPA), natural gas wells producing from a strata in excess of 15,000 feet were classified as "deep, high cost wells" and, therefore, "deregulated" or exempt from price controls heretofore imposed. 15 U.S.C. § 3317 (c)(1). Contract price on this specified production was permitted to fluctuate with market demand.

Transcontinental Gas Pipe Line Corporation (Transco) is an interstate pipeline company which purchases natural gas from fields in Texas, Louisiana and Mississippi. The

pertinent facts of the contractual activities of Transco which gave rise to this appeal are accurately and succinctly represented in the opinion of the Mississippi Supreme Court, 457 So.2d 1298 (1984). J.S. App. A. At an irreducible minimum, the factual controversy may be stated thusly:

1. The Greens Creek Field and East Morgantown Field are two natural gas fields located in Marion County, Mississippi. Both fields are produced from the Harper Sand Gas Pool, and all wells in question were drilled below 15,000 feet. J.S. App. A, 8a.

2. Between 1978 and 1980, Transco entered into production contracts with various entities to the extent that its purchase of gas encompassed both the Green Creek and Morgantown fields. By 1982, Transco had approximately thirty-five (35) different contracts with various owners and producers. J.S. App. A, 8a-9a.

3. Under accepted unit-field practice, when a substantial producer-operator (one holding a significant gas production interest in the area) signed a contract with a purchaser, the owners of the smaller undivided interest which participated in the production unit were paid according to the provisions of that contract. J.S. App. A, 9a.

4. Because of market price fluctuations, Transco (effective July 1, 1982) notified its contracting producers that it, as purchaser, would no longer purchase gas from "non-contract producers". The provisions of outstanding contracts would, however, be honored. J.S. App. A, 11a. Prior to the July date, Transco had purchased and paid for all gas at the same price and on the same terms and conditions as it purchased and

paid its contract owners, operators or producers. J.S. App. A, 9a.

5. In effect, any and all producers who were unit producers and members of the conservation field would not be compensated for their previously recognized percentage interest in the gas pool. This practice ignored the equitable "taking" effect of Rule 48 of the Mississippi Oil and Gas Board; it amounted to continued production without just compensation. J.S. App. A, 14a.

6. Upon petition of the excluded non-contractual owners, the Oil and Gas Board ordered Transco to comply with its Rule 48, and ratably take from *all* owners, operators or producers in accordance to their calculable percentage of field and pool production without discrimination. J.S. App. A, 15a-16a.

As required by the applicable procedural statute, Transco appealed to the Circuit Court of the First Judicial District of Hinds County, § 53-1-39, Miss. Code of 1972, which affirmed the order of the Board. J.S. App. B, 59a.

The Supreme Court of Mississippi upheld the validity of Rule 48 of the State Oil and Gas Board. 457 So.2d 1298. In so doing, the Court discussed a number of federal constitutional issues presented by the appellants below: The Court found that federal preemption was not present since, as a matter of obvious fact, the subject matter in controversy was "deregulated gas", 15 U.S.C. § 3317(c)(1); and that the Federal Energy Regulatory Commission had no jurisdiction. Following the principles of *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 90 S.Ct. 884, 25 L.Ed.2d 174 (1970), that Court also determined that the regulation was not an impermissible burden on interstate commerce because it satisfied substantial local interests, *i.e.*, conservation and

protection of the correlative rights of the owners in an indiscriminate fashion.

The proposition that the regulation was void for vagueness was also dismissed by the Court in its decision, citing *Phillips Petroleum Co. v. Oklahoma,* 340 U.S. 190, 192, 71 S.Ct. 221, 222, 95 L.Ed. 204, 205-206 (1950), as was the argument that the "pro-rata" mandate amounted to an abuse of state police power.

This Court noted probable jurisdiction on March 25, 1985.

SUMMARY OF THE ARGUMENT

The existence and enforcement of Rule 48 "ratable take" provision recognizes that the property interests of *all* correlative owners, operators or producers must be protected. The Rule is a reasonable exercise of the police powers of the state to equitably protect the interest of all participants in a recognized common pool of, in this instance, natural gas. For, beyond question, one must first recognize the character of the natural resource sought to be regulated. *Ohio Oil Co. v. Indiana,* 177 U.S. 190, 202-211, 10 S.Ct. ....., 44 L.Ed. 729, 736-740 (1900). To permit capture of oil and gas and to pay only contracted producers to the exclusion of all other property owners who share in a common pool clearly amounts to an appropriation of a recognized property interest which, in and of itself, raises constitutional questions. *Ohio Oil Co., supra,* 177 U.S. 190, 211.

As a matter of commerce, the record of this appeal reflects that between 1978 and 1982, the appellant, Transco executed multiple contracts with various producers in a common natural gas pool in Marion County, Mississippi.

These corporate decisions were made with full knowledge of the deregulation provisions of the NGPA of 1978 and Rule 48 of the Mississippi Oil and Gas Board. As a result of NGPA, natural gas prices were no longer federally controlled at an artificially low level; free market price prevailed, the supply of gas soon increased, and the price for gas to be paid pipelines at the market place decreased.

As a result of market conditions in 1982, Transco sought to maintain its supply of natural gas from a certain common pool by only paying those producers then under contract, declining adequate pro rata compensation to non-contract pool participants. Mississippi regulation requires that all owners, operators or producers share in the production of a common pool.

Transco argues that Rule 48 of the State Oil and Gas Board is invalid because federal law has preempted State authority in this case. Transco also argues that such a regulation would be costly to them, raise the price of natural gas, and impede interstate commerce. This argument ignores reality. The Natural Gas Policy Act, specifically 15 U.S.C. § 3431(a)(1)(B)(i) and 15 U.S.C. § 3317(c)(1), excludes the gas pool in question from federal regulation. Under these circumstances, recent case authority permits reasonable state regulation, *Hillsborough County, Fla. v. Automated Medical Laboratories, Inc.*, ... U.S. ..... (No. 83-1925, 53 U.S.L.W. 4612, June 3, 1985); *Metropolitan Life Insurance Co. v. Commonwealth of Massachusetts*, ... U.S. ..... (Nos. 84-325 and 84-326, 53 U.S.L.W. 4616, June 3, 1985), particularly since the dictates of *Northern Natural Gas Co. v. State Corporation Commission of Kansas*, 372 U.S. 84, 83 S.Ct. 646, 9 L.Ed.2d 601 (1963) do not apply to deregulated natural gas.

Transco cannot argue that Rule 48 is an impediment to its business activities while participating in interstate commerce. It admits that the federal statute permits the passage of any price increase to the consumer, 15 U.S.C. § 3431(c). If we accept Transco's raw economic argument, without ratable take, some common pool participants would not be compensated for their recognized interest and the pool would eventually be drained. Rule 48 protects all parties; this state interest satisfies the test of *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 90 S.Ct. 844, 25 L.Ed.2d 174 (1970).

ARGUMENT

I.

When the Price of Certain Natural Resources Was Deregulated As Provided by the Natural Gas Policy Act of 1978, 15 U.S.C. § 3431(a)(1)(B)(i), the Congress Ceded to the States, and in This Instance Mississippi, the Authority to Impose Its Regulations (Rule 48) to Prevent Waste and Drainage and to Protect the Rights of the Correlative Owners, Operators or Producers in a Designated Pool and/or Drilling Unit.

The appellants here challenge only the enforcement of Rule 48 of the Mississippi Oil and Gas Board as it applies to natural gas gathered and produced from a particular strata. According to the decision of the Mississippi Supreme Court, 457 So.2d 1298, 1313, their judgment was limited:

> A caveat. Today's facts and today's holding concern "deregulated gas". The Harper Sand Gas Pool lies

> at a depth of 15,000 feet below the surface of the earth. The wells in issue produce "high-cost natural gas", 15 U.S.C. § 3317(c)(1), . . .

It is from these undisputed facts and this judgment that appellee must begin its analysis and from this vantage point that the Court should begin its scope of review. *Mississippi University for Women v. Hogan*, 458 U.S. 718, 723, 102 S.Ct. 331, 78 L.Ed.2d 1090, 1097 (1984), fn. 7, citing *Black v. Cutter Laboratories*, 351 U.S. 292, 76 S.Ct. 824, 100 L.Ed. 1188 (1956).

Appellant argues that the Federal Energy Regulatory Commission preempts the Oil and Gas Board in regulating the gas production at issue. That proposition misses the mark. Either the language of the Natural Gas Policy Act of 1978 means what it says or it does not.

Appellee Oil and Gas Board agrees with the rationale of the State Supreme Court, 457 So.2d 1298, 1316:

> It is our reading of the Natural Gas Policy Act of 1978 that wellhead sales of the sort of gas with which we are here concerned have been effectively deregulated. We are concerned here with high cost natural gas, 15 U.S.C. § 3317(c)(1), which as a matter of law is no longer subject to FERC (formerly FPC) jurisdiction. 15 U.S.C. § 3431(a)(1)(B)(i). Congress has declared that the first sale of deregulated gas is never made subject to the Natural Gas Act or to FERC's jurisdiction under that act, and "dedicated gas" which is determined to be deregulated gas ceases to be subject to the NGA or FERC's jurisdiction under the NGA. With respect to this category of gas, the regulatory situation existing at the time *Northern Natural* was decided has thus been altered radically.

NGPA Section 601(a)(1)(A), (B) and (D), provide as follows:

> SECTION 601. COORDINATION WITH THE NATURAL GAS ACT-
>
> (a) JURISDICTION OF THE COMMISSION UNDER THE NATURAL GAS ACT.-
>
> (1) SALES.-
>
> (A) NATURAL GAS NOT COMMITTED OR DEDICATED-*For purposes of section 1(b) of the Natural Gas Act,* effective on the first day of the first month beginning after the date of the enactment of this Act, *the provisions of the Natural Gas Act and the jurisdiction of the Commission under such shall not apply to natural gas which was not committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act* solely by reason of any first sale of such natural gas.
>
> (B) COMMITTED OR DEDICATED NATURAL GAS-Effective beginning on the first day of the first month beginning after the date of the enactment of this Act, *for purposes of section 1(b) of the Natural Gas Act, the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act and which is-*
>
> (i) High-cost natural gas (as defined in Section 107(c)(1), (2), (3) or (4) of this Act); [Emphasis added].

The "Joint Explanatory Statement of the Committee on Conference" of the Congress, which accompanied the NGPA, makes clear what the conferees intended that Section 601(a)(1) accomplish.

> The conference Agreement limits the jurisdiction of the Commission under the Natural Gas Act in a manner similar to the House-passed bill. *Natural gas not committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act is never made subject to the Commission's jurisdiction under sec. 1(b) of the Natural Gas Act. The Commission's jurisdiction under section 1(b) of the Natural Gas Act ceases on the first day of the first month beginning after the date of enactment of this Act for the following categories of natural gas: High-cost natural gas* which qualifies for deregulated price treatment under section 107(c)(1), (2), (3), or (4); [Emphasis added].

* * *

Section 601(a)(1) [15 U.S.C. § 3431(a)(1)] means what it says-the Natural Gas Act of 1938 (NGA) and FERC's jurisdiction under the Act *never* apply to deregulated gas, and certain other categories of gas. That message is decisive of the preemption issue in this case. The reason the Supreme Court voided the ratable take order in *Northern Natural* was because at that particular point in time such an order substantially affected gas which was subject to the FPC's (FERC's) jurisdiction under the NGA. If the NGA and FERC's jurisdiction under the NGA no longer extend to deregulated gas, and FERC has no authority to regulate the first sales and purchases of deregu-

lated gas either directly or indirectly, then *Northern Natural* does not dictate a preemption of otherwise existing state authority.

On June 3, 1985, in *Hillsborough County, Fla. v. Automated Medical Laboratories, Inc.*, ... U.S. ..... (No. 83-1925, 53 U.S.L.W. 4612, 4614), this Court again specifically affirmed the right of a state agency to regulate commercial activity when federal police power is absent:

> . . . "Where . . . the field that Congress is said to have pre-empted has been traditionally occupied by the States 'we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.' " *Jones v. Rath Packing Co.*, 430 U.S., at 525 (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S., at 230) (citations omitted). *Cf. Kassell v. Consolidated Freightways Corp.*, 450 U.S. 662, 670 (1981) (deference to state regulation of safety under the dormant Commerce Clause); *id.*, at 681, n. 1 (Brennan, J., concurring in judgment) (same); *id.*, at 691 (Rehnquist, Jr., dissenting) (same). Of course, the same principles apply where, as here, the field is said to have been pre-empted by an agency, acting pursuant to congressional delegation. Appellee must thus present a showing of implicit pre-emption of the whole field, or of a conflict between a particular local prov ion and the federal scheme, that is strong enough to overcome the presumption that state and local regulation of health and safety matters can constitutionally coexist with federal regulation.

Given the clear indication of the FDA's intention *not to pre-empt* and the deference with which we must review the challenged ordinances, we conclude that

these ordinances are not pre-empted by the federal scheme.

* * *

. . . To infer pre-emption whenever an agency deals with a problem comprehensively is virtually tantamount to saying that whenever a federal agency decides to step into a field, its regulations will be exclusive. Such a rule, of course, would be inconsistent with the federal state balance embodied in our Supremacy Clause jurisprudence. See *Jones v. Rath Packing Co.*, 430 U.S., at 525.

The companion decision, *Metropolitan Life Insurance Company v. Commonwealth of Massachusetts*, ... U.S. ..... (Nos. 84-325 and 84-326, 53 U.S.L.W. 4616), stands for the same constitutional proposition as *Hillsborough County, supra.*

II.

The "Ratable Take" Provision of Rule 48 of the Oil and Gas Board of Mississippi Does Not Impede Interstate Commerce Because Its Operation Is Reasonably Calculated to Protect a "Legitimate Local Interest" - Fairness, That Is, to Insure an Appropriate Share fo Each Correlative Owner, Operator or Producer.

The dictates of the balancing test of *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 90 S.Ct. 844, 25 L.Ed.2d 174 (1970), cannot be ignored, and there can be little doubt that the "legitimate local interest" was to protect all affected correlative owners, operators or producers from being excluded from an ongoing commercial transaction.

The true and entirely legitimate local interest here implicated is fairness. Rule 48 is a rule of equity.

The drainage phenomenon is a fact of life of natural gas production. *Shell Oil Company v. James,* 257 So.2d 488, 494-495 (Miss. 1971). The state through its Oil and Gas Board has acted in this and other ways to assure equity and fairness between and among the varying interests in a common source of supply. *See Phillips Petroleum Co. v. Millette,* 221 Miss. 1, 15-17, 72 So.2d 176, 179 (1954) (protection against loss through drainage required by fundamental notions of equity and justice).

We regard fairness as among the more noble purposes of the state. It is a fundamental component of the idea of justice. Rawls, *A Theory of Justice* (1971). That we are concerned here with the distribution of material and highly valuable resources does not denigrate or render less noble the state's duty to assure fairness between all persons affected. A laudable feature of Rule 48 in the present context is that it applies to owners of interests in the common source of supply without reference to whether they be Mississippians. Getty is entitled to the same fair treatment as is Coastal as are the Fairchilds as is Tomlinson and as is Inexco and so forth.

> *Transcontinental Gas Pipeline v. State Oil and Gas Board,* 457 So.2d 1298, 1321 (1984).

This Court recognized that "ratable take" is a necessary protection device (state regulation) in *Ohio Oil Co. v. Indiana,* 177 U.S. 190, 210, 10 S.Ct. ....., 44 L.Ed. 729, 739 (1900). While defining the nature of natural gas, that opinion stated:

> . . . But there is a coequal right in them all to take from a common source of supply the two *substances which in the nature of things are united, though separate. It follows from the essence of their right and

> from the situation of the things as to which it can be exerted, that the use by one of his power to seek to convert a part of the common fund to actual possession may result in an undue proportion being attributed to one of the possessors of the right to the detriment of the others, or by waste by one or more to the annihilation of the rights of the remainder. Hence it is that the legislative power, from the peculiar nature of the right and the objects upon which it is to be exerted, can be manifested for the purpose of protecting all the collective owners, by securing a just distribution, to arise from the enjoyment, by them, of their privilege to reduce to possession, and to reach the like end by preventing waste.

Cited with approval, Energy Reserves Group, Inc. v. Kansas Power & Light Company, 459 U.S. 400, 419, 103 S.Ct. 697, 74 L.Ed.2d 569, 586 (1983).

Further, the commercial problems of Transco were of its own making. 457 So.2d 1298, 1322.

> Many important provisions of that contract reflect that the parties carefully considered future eventualities. The so-called take-or-pay provision obligating Transco to pay whether it takes the production made available by Getty is one such clause. Transco's problem is that it failed to protect itself against the market glut and declining prices consumers are willing to pay for natural gas. It is not now and never has been the function of this Court to relieve a party to a freely negotiated contract of the burdens of a provision which becomes more onerous than had originally been anticipated. *Bunting v. Orendorf,* 152 Miss. 327, 332, 120 So. 182, 183 (1929); *Jamison v. McDaniel,* 25 Miss. 83, 86 (1852); *Gulf Oil Corp. v. Federal Power Commission,* 563 F.2d 588, 598-600 (3d Cir. 1977).

If Rule 48 is not enforced, the real injured party is the unprotected owner, operator or producer. Transco has the right to pass the costs it incurs in producing or transporting natural gas through to the consumer. 15 U.S.C. § 3431(c).

CONCLUSION

Initially, the claims of Transco must be put in perspective. The issue is entirely confined to the Board's order concerning the Harper Sand Gas Pool which lies below 15,000 feet and in which the wells in question produce "high-cost" natural gas which is unregulated pursuant to 15 U.S.C. § 3317(c)(1) and 15 U.S.C. § 3431(a)(1)(B)(i). No other fields, pools, and/or wells are involved in this appeal.

The State has not attempted to tell appellant how much gas to take or what it should pay for the gas. To the contrary, the Order only provides that if Transco decides to take any gas, it must do so ratably.

For the foregoing reasons, the judgment of the Supreme Court of the State of Mississippi should be affirmed.

Respectfully submitted,

EDWIN LLOYD PITTMAN, Attorney General
State of Mississippi
ED DAVIS NOBLE, JR.
Assistant Attorney General
R. LLOYD ARNOLD
Assistant Attorney General
Post Office Box 220
Jackson, Mississippi 39205
(601) 359-3680
Attorneys for the State Oil and Gas Board of Mississippi

Office-Supreme Court, U.S.
FILED
JUL 18 1985
ALEXANDER L. STEVAS,
CLERK

No. 84-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

BRIEF FOR THE APPELLEE COASTAL EXPLORATION, INC.

GLENN GATES TAYLOR
(Counsel of Record)
COPELAND, COOK, TAYLOR & BUSH
Suite 112 Capital Towers
Post Office Drawer 2132
Jackson, Mississippi 39225
(601) 354-0123

KENNETH I. FRANKS
JAMES RUSSELL TUCKER
HEIDELBERG, WOODLIFF & FRANKS
Suite 1400 Capital Towers
Jackson, Mississippi 39201
(601) 948-3800

Attorneys for Coastal Exploration, Inc.

July 19, 1985

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

BEST AVAILABLE COPY

QUESTIONS PRESENTED

1. *The Preemption Question:* Do the Natural Gas Act of 1938 (NGA) and the Federal Energy Regulatory Commission's (FERC) jurisdiction under § 1(b) of the NGA apply to the "first sale" of gas which has been determined to be deregulated natural gas under Section 107 (c)(1) of the Natural Gas Policy Act of 1978 (NGPA)?

2. *The Commerce Clause Question:* Does the requirement that an interstate gas purchaser must offer to take federally-deregulated gas ratably from the wells which produce from a gas pool, and, in the absence of an agreement as to price, must offer to pay the non-contract owners in the pool a "market price" for their gas constitute a burden on interstate commerce? If so, is the burden excessive in relation to the putative local benefits?

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iv

STATEMENT OF THE CASE 1

1. The NGA 2
2. The NGPA 4
3. The Interests of the State in Requiring the Ratable Take of Gas From a Pool 6
4. The Controversy Between Coastal and Transco. 8
5. What the State Has Required of Transco 14
6. What the State Has Not Required of Transco . 15

SUMMARY OF THE ARGUMENT 16

ARGUMENT 18

I. MISSISSIPPI'S RATABLE TAKE REQUIREMENT IS NOT PREEMPTED 18

1. There Is No Express Preemption 19
2. There Is No Implied Preemption 20

Peerless 22

Phillips 23

Northern Natural 24

The NGPA 25

Why Did Congress Include Section 601 in the NGPA? 26

TABLE OF CONTENTS continued

Page

Section 601(a)(1) 29

Analysis of Section 601 32

3. There Is No Conflict Between Mississippi's Ratable Take Requirement and the NGA/NGPA .. 36

II. MISSISSIPPI'S RATABLE TAKE REQUIREMENT DOES NOT VIOLATE THE COMMERCE CLAUSE 41

1. The Legitimate State Interests Supporting the Ratable Take Requirement 43

2. The Ratable Take Requirement Applies Evenhandedly 43

3. Transco's Claim of Constitutional Regulatory Alternatives 46

CONCLUSION 50

TABLE OF AUTHORITIES

CASES: Page

Arkansas Electric Cooperative Corp. v. *Arkansas Public Commission*, —— U.S. at ——, 103 S.Ct. at 19160 ..... 40, 43

Arkansas Electric Cooperative Corp. v. *Arkansas Public Service Commission*, 461 U.S. 375 (1983) .. *passim*

Auto Transist Co. v. *Brady*, 430 U.S. 274, 288-89 (1977)

Champlin Refining Co. v. *Corporation Commission*, 286 U.S. 210 (1932) 46

Cities Service Co. v. *FEA*, 529 F.2d 1016, 1027 (T.E. C.A. 1975) 24

Cities Service Gas Co. v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950) ..... *passim*

Chevron Chemical Co. v. *Castle*, 641 F.2d 104, 116 (3rd Cir. 1981) 24

Commonwealth Edison v. *Montana*, 453 U.S. 609, 624-29 (1981) 43

Complete Auto Transit Co. v. *Brady*, 430 U.S. 274 (1977) 43

Conoco, Inc. v. *FERC*, 622 F.2d 796 (5th Cir. 1980) .. 34

Energy Reserves Group, Inc. v. *Kansas Power & Light Co.*, 459 U.S. 400 (1983) 20, 24, 39

Exxon Corp. v. *Eagerton*, 103 S.Ct. 2296 (1983) 38, 39

Exxon Corp. v. *Governor of Maryland*, 437 U.S. 117, 127-29 (1978) 43

Hayfield Northern Railroad Co., Inc. v. *Chicago and North Western Transportation Co.*, —— U.S. ——, 104 S.Ct. 2610, 2614 (1984) 20

Hillsborough County v. *Automated Medical Laboratories, Inc.*, 53 L.W. 4612 (June 4, 1985) 39

TABLE OF AUTHORITIES continued

Page

H. P. Hood & Sons, Inc. v. *Dumond*, 336 U.S. 525 (1949) 49

Maryland v. *Louisiana*, 451 U.S. 725, 101 S.Ct. 2114 (1981) 38, 39

Metropolitan Life Insurance Co. v. *Commonwealth*, 53 L.W. 4616 (June 4, 1985) 39

Michigan Canners and Freezer Association, Inc. v. *Agriculture Marketing and Bargaining Board*, —— U.S. ——, 104 S.Ct. 2518 (1984) 18-19

Mid-Louisiana Gas Co. v. *FERC*, 664 F.2d 530, 533 (5th Cir. 1982) 27, 28

Minnesota v. *Cloverleaf Creamery Co.*, 449 U.S. 456, 471-73 (1981) 43

Missouri v. *Kansas Gas Co.*, 265 U.S. 298 (1924) 42

Northern Natural Gas Corp. v. *State Corporation Commission*, 372 U.S. 84 (1963) ..... *passim*

Pacific Gas & Electric Co. v. *State Energy Resources Conservation & Development Commission*, 461 U.S. 190 (1983) ..... *passim*

Pennzoil Co. v. *FERC*, 645 F.2d at 360 (5th Cir. 1981) ..... *passim*

Phillips Petroleum Co. v. *Oklahoma*, 340 U.S. 190 (1950) 22

Phillips Petroleum Co. v. *Wisconsin*, 347 U.S. 672 (1954) 3, 22, 23, 24

Pike v. *Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).. 17, 41, 44

Public Service Commission v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983) 3, 25

TABLE OF AUTHORITIES continued

Page

Public Utilities Commission v. *Attleboro Steam and Electric Co.*, 273 U.S. 83 (1927) 42

Public Utilities Commission v. *Landon*, 249 U.S. 236 (1919) 42

Reeves, Inc. v. *Stake*, 447 U.S. 429, 443-47 (1980) 43

Silkwood v. *Kerr-McGee Corp.*, —— U.S. ——, 104 S.Ct. 615, 621 (1984) 19

Sporhase v. *Nebraska*, 458 U.S. 941, n. 16 (1982) 24

Tenneco, Inc. v. *Sutton*, 530 F.Supp. 411, 417 (M.D. La. 1981) ..... *passim*

OTHER AUTHORITIES:

Mississippi Oil & Gas Production Report (March 1985) 7

18 C.F.R. Sections 154.39 and 154.103 27

124 Cong. Rec. 29099-29109 (9-13-78) 20

124 Cong. Rec. 30011-30035 (9-19-78) 20

"Curtis/Jackson Letter" of September 8, 1978 .... 29, 32

4 Energy Law Journal 251 (1983), *Note: Has The Supreme Court Pulled The Rug From Under The FERC's Electric And Natural Gas Regulation?* .. 3

4 Energy Law Journal 255 (1983), *Note: The Role of the States in Energy Regulation* 3

Federal Programs Advisory Service [FPAS] § 601: 220, pg. 3 ..... 27, 32

Miss. Code Ann. § 53-1-3(k)(1)-(3) (S. 1984) 9

Moody, *The Natural Gas Policy Act of 1978: Analysis and Overview*, 25th Annual Rocky Mtn. Mineral Law Institute 2-1 at 2-89 (1979) 5

TABLE OF AUTHORITIES continued

Page

Moring, *A Quiet Revolution? The FERC Yields Pipeline Jurisdiction to the States and Courts*, Public Utilities Fortnightly at 36. (11-22-84) 41

Section 1(b) of the Natural Gas Act (NGA), 15 U.S.C. § 717(a) ..... *passim*

NPGA Section 107(c)(1) ..... *passim*

NGPA Sections 503 and 602, 15 U.S.C. §§ 3413 and 3432 20

NGPA § 601(a)(1)(A) & (B), 15 U.S.C. § 3431(a)(1)(A) & (B) ..... *passim*

Pierce, *Natural Gas Regulation, Deregulation and Contracts*, 68 Va. L. Rev. 63, 65-72, 86-89 (1982) 4, 5

Pierce, *Reconsidering The Roles of Regulation And Competition In the Natural Gas Industry*, 97 Harv. L. Rev. 345 (1983) 3, 5

Williams, *Federal Preemption of State Conservation Laws After the Natural Gas Policy Act: A Preliminary Look*, 56 Univ. of Colo. L. Rev. 901 (1985) 4, 28, 38

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

BRIEF FOR THE APPELLEE COASTAL EXPLORATION, INC.

STATEMENT OF THE CASE

The State of Mississippi has attached a ratable take requirement to Transco's takes of federally-deregulated gas from a gas pool in Mississippi. In 1950, this Court held that a state ratable take order entered against an interstate pipeline purchaser of gas was constitutional and did not violate the Commerce Clause. *Cities Service Gas Co.* v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950). In 1963, after having interpreted the Natural Gas Act of 1938 (NGA) as applying to producers' sales of gas to interstate purchasers for resale, this Court held that a ratable take order was preempted by the Federal Power Commission's (FPC) jurisdiction over wellhead sales of gas in interstate commerce, because of what the Court

then viewed as a pervasive scheme of federal regulation under the NGA. *Northern Natural Gas Corp.* v. *State Corporation Commission,* 372 U.S. 84 (1963).

In order to bring about the beginning of the end of the national crisis of shortages of gas in the interstate market, shortages which had been caused by the practical effect of the NGA, in 1978 Congress passed the NGPA, "a fundamental change in regulatory outlook." The NGPA exempts the wellhead sale and purchase of federally-deregulated natural gas from the jurisdictional provisions of the NGA which *Northern Natural* held preempted the state ratable take order in that case.

Thus, the States, once again, are free to attach a reasonable ratable take requirement to an interstate pipeline's takes of federally-deregulated natural gas, and Mississippi's simple ratable take requirement is neither preempted nor does it violate the Commerce Clause. *Transcontinental Gas Pipe Line Corporation* v. *State Oil & Gas Board,* 457 So.2d 1298 (Miss. 1984) ("Transco").

Why is this now the case? A review of regulatory history and the facts of the controversy between Coastal and Transco is in order.

1.

The NGA

Prior to November 1978, there *was* a pervasive scheme of federal regulation of first sales, resales and transportation of natural gas in the interstate market. This pervasive scheme of federal regulation was established under Section 1(b) of the Natural Gas Act (NGA), 15 U.S.C. § 717(a), which regulated, *inter alia,* the "sale in interstate commerce of natural gas for resale for ultimate public consumption" and "natural gas companies engaged in such transportation or sale." The NGA was designed to fill what was then perceived as a "gap" between what the

states could not regulate and what the federal government had not yet regulated,[1] and had the primary objective of "protection of consumers from exploitation at the hands of natural-gas companies."[2] These were the same type of considerations which also led to passage of the Federal Power Act regulating sales of electricity in interstate commerce.

Under its NGA jurisdiction, the Federal Power Commission (FPC) eventually came to regulate every facet of the sale, purchase and transportation of natural gas in the interstate market, beginning with the wellhead or first sale. A producer could not sell or deliver, and a purchaser could not buy or introduce natural gas into the interstate market without FPC approval. The price charged and paid for natural gas had to be "just and reasonable" as determined by the FPC. Sales could not be terminated without FPC approval. The scheme of federal regulation was truly pervasive and comprehensive.[3] The country, however, paid a heavy price for this pervasive scheme.

This pervasive scheme of federal regulation under the NGA resulted in artifically low NGA-mandated just and reasonable wellhead prices which were below the true market value of natural gas. These low prices, coupled with the non-price federal regulations attending any attempt to sell or cease to sell natural gas in the interstate market, reduced or altogether eliminated the incentives

---

[1] *See Note: Has The Supreme Court Pulled The Rug From Under The FERC's Electric And Natural Gas Regulation?* 4 Energy Law Journal 251 (1983); *Note: The Role of the States In Energy Regulation,* 4 Energy Law Journal 255 (1983).

[2] *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672 (1954). *See* Pierce, *Reconsidering The Roles of Regulation And Competition In the Natural Gas Industry,* 97 Harv. L. Rev. 345 (1983).

[3] *See, e.g.,* discussions in *Tenneco, Inc.* v. *Sutton,* 530 F.Supp. 411, 417 (M.D. La. 1981); *Public Service Commission* v. *Mid-Louisiana Gas Co.,* 463 U.S. 319 (1983).

for producers to discover new gas reserves and sell that gas in the interstate market. Instead, as the years passed by producers sold more and more of their new gas into the federally-unregulated intrastate markets where the producers could sell their gas at market prices. Consequently, total reserves and deliverability dedicated to the interstate market declined while the interstate demand for gas increased. By the mid-1970s, this dual market system resulted in severe shortages of natural gas in the interstate market, shortages which have been described as a "national crisis," while at the same time the intrastate markets enjoyed a surplus of natural gas. By the mid-1970s, there was a general consensus that the pervasive scheme of federal regulation under the NGA had not worked to provide consumers of interstate gas with a dependable supply of natural gas. With gas deliveries in the interstate market being reduced or altogether curtailed to industries, electric utilities and schools, it became apparent that the pervasive scheme of federal regulation under the NGA had nurtured an economic disaster of national proportions.[4] Simply put, the pervasive scheme of federal regulation had not worked.

2.

The NGPA

The nation's recovery from that abysmal situation began in November 1978 with passage of the NGPA, correctly described as "a fundamental change in regulatory outlook."[5] This regulate-to-deregulate plan eliminated the

---

[4] *See, e.g.,* discussions in *Tenneco, Inc.* v. *Sutton, supra,* 530 F. Supp. at 420-21; *Pennzoil Co.* v. *FERC,* 645 F.2d 360 (5th Cir. 1981); Pierce, *Natural Gas Regulation, Deregulation and Contracts,* 68 Va. L. Rev. 63, 65-72 (1982).

[5] *Pennzoil Co.* v. *FERC, supra,* 645 F.2d at 378. *See* Williams, *Federal Preemption of State Conservation Laws After the Natural Gas Policy Act: A Preliminary Look,* 56 Univ. of Colo. L. Rev. 901 (1985) [herein cited as "Williams"].

difference between the interstate and intrastate markets, and instituted a comprehensive plan of federal deregulation under which some gas was immediately deregulated, other gas was gradually deregulated, regulated prices were allowed to rise, and the "first sale" transaction involving new gas was exempted from FERC's jurisdiction under § 1(b) of the NGA, all in order to provide producers and pipeline purchasers of gas with the degree of freedom from federal regulation and the price incentives necessary to encourage producers to discover new gas reserves and sell that gas in the interstate market, and thereby end the national crisis of shortages of natural gas in the interstate market.[6]

The NGPA creates various incentive categories of natural gas in order to encourage producers to find new gas reserves and sell their gas in the interstate market. One of these categories is "high-cost natural gas" under Section 107(c)(1) of the NGPA, being gas which is found at depths below 15,000 feet. The "high-cost" terminology does not refer to the sales price of the gas, but to the significant costs and risks incurred to find and produce gas found at great depths. Consequently, as an incentive to discover and produce this type of gas, this type of gas would be completely price deregulated as of November 1, 1979 and, as in the case of other new natural gas, the first sale and purchase of this deep gas would never be subject to the FERC's jurisdiction under § 1(b) of the NGA. *See* NGPA § 601(a)(1)(A) & (B), 15 U.S.C. § 3431(a)(1)(A) & (B).

---

[6] *See, e.g.*, Moody, *The Natural Gas Policy Act of 1978: Analysis and Overview*, 25th Annual Rocky Mtn. Mineral Law Institute 2-1 at 2-89 (1979); Pierce, *Reconsidering The Roles of Regulation And Competition In the Natural Gas Industry*, 97 Harv. L. Rev. 345 (1983); Pierce, *Natural Gas Regulation, Deregulation and Contracts*, 68 Va. L. Rev. 63, 86-89 (1982); *Pennzoil Co.* v. *FERC*, *supra*, 645 F.2d at 367, n. 13; Williams, *supra*.

The price and non-price incentives provided by the NGPA caused a literal stampede by producers to drill more wells to deeper depths to discover gas in deep gas pools, pools which are typically characterized by high deliverability and substantial reserves. Interstate pipeline purchasers of gas, freed from the constraints the NGA imposed on their ability to purchase new gas and pay competitive market prices, responded with fierce competition to bid up and buy reserves of new gas. It was against the background of that national crisis of gas shortages in the interstate market and the passage of the NGPA that the deep gas pools in the Greens Creek and East Morgantown Fields in Jefferson Davis and Marion Counties, Mississippi were developed, Transco began taking natural gas from those fields, the present controversy developed between Coastal and Transco, and the State required Transco to take gas ratably.

The legitimate state interests which support the ratable take requirement at issue are rooted in the manner in which gas must be taken from a gas pool so that the coequal and correlative rights of the owners are protected and each owner is afforded the opportunity to recover his just and equitable share of gas and is treated fairly. These interests are evident from a review of the realities of producing a gas pool, and the need for each owner in a pool to have the opportunity to sell his ratable share of production on a current basis.

3.

The Interests of the State in Requiring the Ratable Take of Gas From a Pool

A typical gas field is underlain by one or more gas pools and usually is developed by a few operators, as few as one or two. An operator usually owns one of the largest interests in the wells it operates. The operator oversees drilling, completion and operation of the wells and under-

takes to obtain a purchaser for the oil and gas produced. In negotiating to sell the production, the operator's bargaining position is substantial because the other owners in the well generally will sell their gas to the purchaser selected by the operator.

A pipeline purchaser of gas generally attempts to buy all of the gas to be produced from a given field in order to justify the significant capital investment required to build a pipeline connection, and to obtain a long term supply of gas. While "split-stream" sales of gas to more than one purchaser can occur, a typical gas field is characterized by a single pipeline purchaser who buys gas for resale. While there may be a choice of pipeline purchasers at the inception, once a purchaser is selected and its facilities are connected to the wells, that purchaser then provides what is the only "market" for the gas produced from the wells.[1] For all practical purposes, the purchaser monopolizes the market in the field. This monopsony condition can prevail even though the pipeline has less than fifty percent of all of the owners in the wells under written contracts.

The custom and practice in the industry has been for the owners of small interests in a gas unit to sell their gas to their operator's purchaser on the same terms and conditions as the operator sells its gas. J.A. 30-31, 76, 123-124, 133, 155, 231-232. In Mississippi, this practice has developed in part because Mississippi's law of co-tenancy can result in there being numerous owners in a given gas unit. J.A. 123-124. Thus, the practice has been for the pipeline purchaser to contract with the operator and other owners of substantial interests, and, in order to avoid the administrative tasks of contracting directly with all of the many

---

[1] There are 198 pools in the State of Mississippi, but only 36 gas purchasers. Approximately 9 of the purchasers are interstate pipeline purchasers. *See* Mississippi Oil & Gas Production Report (March 1985) at page 96.

owners of small interests, to buy those owners' share of gas production without a written contract but on the same terms and conditions as are provided for in the operator's contract. Historically, therefore, it has generally been the case that every owner who has wanted to sell his gas has had access to the market at the wellhead.

There are, however, reasons more important than mere cash flow for all owners in a pool to have the opportunity to produce their gas ratably and sell it on a current basis. These reasons include the prevention of drainage between competing wells and the recovery of each owner's just and equitable share of gas in the pool. J.A. 13-15, 77-78.

A gas pool, particularly a deep gas pool, is under tremendous pressure. Consequently, the gas in a pool will migrate to an area of reduced pressure, such as the borehole of a gas well. Theoretically, one well completed into any point of a pressure depletion pool will drain the entire pool, and not just that part of the pool which lies beneath the geographical limits of the well's production unit. Thus, the wells which produce from a common pool compete with one another to obtain their respective just and equitable shares of gas in the pool. In Mississippi, the recovery of those respective shares is based on the ratable take of the respective allowables of the wells.

In Mississippi a well's "allowable" is the maximum rate of production at which the well is allowed to be produced, sometimes referred to as its "maximum efficient rate of flow." Owing to the different points at which the wells in a pool are completed, and differing sand thicknesses, permeabilities, and porosities, the wells completed into a pool usually do not have identical allowables. Some wells simply are capable of producing more gas than others. While allowables may vary from well to well, the wells recover their respective just and equitable shares of gas from the pool by ratably taking gas, that is, by taking gas from all of the wells at the same percentage of their respective allowables.

Without the ratable taking of gas from a pool, some wells (and owners) would drain offsetting units and recover more than their just and equitable share of gas in the pool, resulting in prohibited "waste" and the abuse of the coequal and correlative rights of the owners in the pool. Unratable takes also create unnatural drainage patterns, the premature dissipation of reservoir energy, and damage to the productive capability of a pool. *See* Miss. Code Ann. § 53-1-3(k)(1)-(3) (S. 1984). A ratable requirement protects against these "evils." The requirement also, quite literally, allows each owner the opportunity to recover his just and equitable share of production on a *current* basis, an important factor indeed.

As production continues from a gas pool, the reservoir pressure declines. With production and the passage of time, it becomes more difficult, expensive and risky to recover the remaining gas in a pool. Typically, compressors are added and enhanced recovery techniques are necessary in order to continue to produce gas from the pool. Eventually, the pressure of the pool will decline to such an extent that some gas, though remaining, will never be recovered. Thus, the owner of a 1% interest in a gas pool cannot wait until 99% of the gas in the pool has been recovered and still have a fair opportunity to recover his just and equitable share of gas. Consequently, if the owner of a small interest is to have more than an illusory right to recover his just and equitable share of gas in a pool, that owner must be allowed to recover his gas on a current basis, along with his operator. An owner, however, cannot recover his gas on a current basis unless he has the *opportunity* to sell his gas at the wellhead on a current basis.

Once produced and brought to the surface, gas, unlike oil, cannot be practically tanked, stored or warehoused by a producer; it must be sold immediately. Thus, the opportunity to produce gas is inextricably intertwined with the opportunity to sell gas at the wellhead; one cannot exist without the other. To condition a producer's right

to produce his gas ratably on his having a market, but then deny him access to the market at the wellhead, is to treat him unfairly and defeat his right to recover his just and equitable share. For this reason, an owner's opportunity to sell gas at the wellhead along with the other taking owners is the key to ratable taking and the prevention of drainage.

This need for fair treatment is underscored in the case of the owner of a small interest in a gas unit. Rarely, if ever, is a pipeline purchaser willing to build a pipeline or gathering system to buy a mere one or two percent of the gas produced by a well. Practically, the owner of a small interest has the Hobson's choice of selling his gas to the operator's purchaser, or to no one at all, inasmuch as the gas will be drained if not produced and sold.

These are the facts of life in a gas pool. Unratable takes of gas caused by a purchaser's refusal to buy gas from some owners is fundamentally unfair and deals an economic death-blow to the small producer who must have the opportunity to recover and sell his just and equitable share of gas along with his co-owners in order to pay his royalty owners, pay his share of drilling and completion costs, compete with his operator and other oil companies for new drilling rights, and drill new wells.

Transco's refusal to buy Coastal's ratable share of gas produced from the Harper Sand Gas Pool, and Transco's resulting unratable takes of gas from that pool, prompted the ratable take requirement at issue.

4.

The Controversy Between Coastal and Transco

In 1982, six (6) wells produced from the Harper Sand Gas Pool which underlies the south end of the Greens Creek Field and the north end of the East Morgantown Field in Jefferson Davis and Marion Counties, Mississippi. J.A. 6-9.

Getty Oil operated three (3) of the wells, Tomlinson Interests operated one (1), and Florida Exploration Company operated two (2). The State Oil and Gas Board of Mississippi has classified all of the wells as "deep, high-cost" wells under Section 107(c)(1) of the NGPA. Coastal owns a 2½% working interest in one of the Getty-operated wells, and less than a 1% working interest in each of three (3) remaining wells, one operated by Getty, one by Tomlinson and one by Florida. Coastal participated in drilling each of these four (4) wells and has paid its share of drilling, completing and operating costs. J.A. 28-30.

In August 1980, Getty entered into a gas purchase contract with Transco. That contract resulted in a price at the wellhead of $7.907 per MMBTU. At that point in time, the industry practice was for a purchaser to contract with the owners of substantial interests in a well and with the operator of the well, and then to purchase the gas of the remaining owners of small interests on the same terms and conditions as provided for in the operator's contract. J.A. 26, 30-31, 76, 123-124, 133, 155, 231, 232. The present case mirrors that practice.

Transco never offered Coastal the same contract which Transco offered Getty. J.A. 30. After learning that Getty had entered into a contract with Transco, Coastal wrote and asked Transco for a copy of the contract, but Transco refused to provide a copy. Coastal then obtained a copy of the contract from Getty. Coastal then agreed that Getty would sell all of Coastal's gas to Transco on the same terms and conditions as Getty sold its gas to Transco. J.A. 78-83.

First production from the pool began in April 1981, with Transco taking all of the gas produced, including Coastal's gas. As other wells were completed into the pool, this same procedure was followed. Transco knew it was purchasing gas from owners like Coastal with whom it did not have a written contract, the so-called "non-contract owners." J.A. 133, 230.

This situation continued until May 1982 when Transco notified Getty and Tomlinson that effective June 1, 1982 (later changed to July 1, 1982) Transco would no longer take or purchase the gas of the non-contract owners. However, because of certain provisions of the Florida-Transco gas contract, Transco would continue to purchase non-contract owners' gas produced from the Florida-operated wells and pay those owners the same price Transco paid Florida. J.A. 39-42.

After receiving this notice from Transco, Getty and Tomlinson notified Coastal that they, as operators, would not produce Coastal's share of gas from the wells they operated unless Coastal obtained its own gas purchase contract. Being unable to secure another purchaser, Coastal asked Transco to be allowed to ratify Getty's 1980 contract. Transco refused, unless Coastal would agree to amend the pricing provisions to add a "market-out clause," a clause which would allow Transco to reduce the purchase price if the price became "uneconomic." Coastal rejected this offer, whereupon Transco refused to take any of Coastal's gas at *any* price.

Effective July 1, 1982, as to the Getty-operated wells, and effective August 19, 1982, as to the Tomlinson-operated well, Transco ceased to take gas attributable to the interests of the non-contract owners until and unless an owner accepted Transco's market-out offer. As a result, Transco's takes of gas and the rates of production from the common pool by these wells were "cutback" to below the maximum efficient rate of flow of the wells. Thereafter, for all practical purposes, the wells produced only and Transco purchased only a rate of production equal to the operators' and other contract owners' interests in the maximum efficient rate of flow from the wells.

The situation with the two (2) Florida-operated wells was different. Transco continued to purchase the non-contract owners' gas produced from these two (2) wells on

the same terms and conditions and at the same price which Transco paid for Florida's gas, $8,4066 per MMBTU. Thus, while Transco cut back its takes of gas from the Getty-operated and Tomlinson-operated wells to below their respective allowables, Transco continued to take gas from the two Florida-operated wells at their respective allowables.

On July 29, 1982, Coastal filed its Petition with the State Oil and Gas Board asking that Transco be prohibited from committing "waste" by taking gas unratably from the wells, and be required to comply with Statewide Rule 48* by ratably taking gas from the wells producing from the pool and purchasing without discrimination in favor of the operators against Coastal.

At the conclusion of a three-day trial, the Board ruled in favor of Coastal and the other intervening producers, and directed Transco to comply with Statewide Rule 48. In relevant part, the Board ordered that "in the event it so chooses and elects to take and purchase gas from said common pool, Transco shall ratably take and purchase without discrimination in favor of the operators, Getty and Tomlinson against Coastal, the Fairchilds and Inexco."

The Mississippi Supreme Court held that the state ratable take order was not preempted and did not violate the Commerce Clause. The Court, however, modified the order as a matter of state law, holding:

> "We affirm so much of the order of the State Oil and Gas Board as requires Transco, if it takes at all from a common source of supply, to take ratably; that is, Transco is required to offer in good faith to purchase from every one of the various producing interests in the common source of supply the same percentage of

---

* "Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, or producers shall purchase without discrimination in favor of one owner, operator or producer against another in the same common source of supply."

> those producers' gas as it purchases from that producer the highest percentage of whose interest Transco takes. • • •
>
> A caveat need be added: We do not hold that a pipeline purchaser may offer any terms, take-it-or-leave-it, and meet its Rule 48 obligations. Offering a working interest owner a choice between a substantially below market price or otherwise wholly unreasonable terms, on the one hand, and drainage on the other, is simply not a ratable taking and is a violation of Rule 48. To comply with this Rule 48 obligations the pipeline must offer in good faith reasonable terms, including a reasonable price, determined by reference to prevailing market conditions and other appropriate economic considerations.
>
> Of course, nothing in Rule 48 requires that Transco take any gas from a given source of supply. If it takes at all, however, it must take, or in good faith offer to take, ratably."

Transco, supra, 457 So.2d at 1327, 1331.

5.

What the State Has Required of Transco

The ratable take requirement at issue is intended to prevent reasonably avoidable drainage between gas units, to afford each "owner" in a pool the opportunity to recover his just and equitable share of gas from a pool, to make that opportunity meaningful by giving each owner access to the market which is available at the wellhead, and to treat the owners fairly.

The ratable take requirement is two-fold and is very simple: First, if and when Transco takes federally-deregulated gas from the pool, Transco must offer to take whatever quantities of gas it desires ratably from all of the wells. Second, for the gas of those owners who do not have a written contract with Transco, but who want to

sell their gas, in the absence of an agreement, Transco must offer to pay a "market price."

6.

What the State Has Not Required of Transco

Given the many ridiculous misrepresentations made by Transco and the FERC about what the State supposedly has required of Transco, it is an appropriate time to consider what the State has *not* required.

The State has not required Transco to take more gas than it needs, nor to take the full allowable of any well(s), nor to take the full allowable of any pool, nor to give any producer a contract, nor to pay anyone "take-or-pay-money," nor to pay a fixed price, nor to pay a higher-than-market price, nor to take more expensive gas to the exclusion of less expensive gas, nor to take any gas at all. Thus, the representations that Mississippi has *required* or *forced* production "in excess of market demand," or has required Transco to take "high cost" gas have no basis in fact. They are misrepresentations.

There simply is no state requirement that Transco must take gas in excess of Transco's needs. In any given month or period of time, Transco, judging what its needs are, may take 100% of the pool's allowable, or 1% of the pool's allowable, or no gas at all. Likewise, the State has not required Transco to pay a "high cost" for any gas. For NGPA well category purposes, the gas in question *is* "high-cost natural gas" under § 107, but there is *nothing* "high" about the price Transco must offer to pay for the non-contract owners' gas whenever Transco decides to take gas from the pool. In the absence of an agreement on price, Transco must offer to pay a mere market price. The State has not even attempted to dictate what that price should be. Transco has responded to this requirement by paying the non-contract owners Transco's "market-out" price since December 1982.

SUMMARY OF THE ARGUMENT

1. *The Preemption Question:* Do the NGA and the FERC's jurisdiction under § 1(b) of the NGA apply to the "first sale" of gas which has been determined to be deregulated natural gas under Section 107(c)(1) of the NGPA? No. The answer to that narrow question lies in the clear language of Section 601(a)(1) of the NGPA. Some case history is in order. In *Cities Service Gas Co.* v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950) (*"Peerless"*), the Court upheld the constitutionality of a state ratable take/minimum price order entered against an interstate gas purchaser. The Court, however, did not consider the effect of the NGA on the validity of such an order. That effect was considered thirteen (13) years later in *Northern Natural Gas Co.* v. *State Corporation Commission of Kansas*, 372 U.S. 84 (1963), which held invalid a state ratable take order directed against an interstate pipeline company because the State's order invaded the Federal Power Commission's (FPC) *then-existing* exclusive regulatory jurisdiction under Section 1(b) of the NGA, jurisdiction and regulatory authority which, at that point in time, extended to a producer's sale and a pipeline's purchase of natural gas in the interstate market. The NGPA, however, brought about a fundamental change in the pervasive regulatory scheme under the NGA. Specifically, Section 601(a)(1)(A) & (B) of the NGPA provides that the first sale of, *inter alia,* deregulated "high-cost natural gas" is *never* made subject to either Section 1(b) of the NGA or FERC's jurisdiction under Section 1(b). Because the FERC no longer has any statutory authority to regulate the first sale transaction involving that category of natural gas, the statutory reasons for the result in *Northern Natural* no longer exist in the case of that category of gas, and the State, once again, is free to attach a ratable take requirement to that first sale transaction. *Peerless.* Thus, Mississippi's ratable take requirement does not actually or theoretically conflict with either the NGA or the NGPA.

Nor does the requirement frustrate or stand as an obstacle to the purposes and objectives of the NGPA. The principal objective of the NGPA was to make *more* new gas available for sale in the interstate market at market prices. Mississipi's requirement fits congruently with that objective by affording all of the owners of federally-deregulated gas in a pool the opportunity to deliver their ratable share of a purchaser's gas needs at a market price.

2. *The Commerce Clause Question:* Does the requirement that an interstate gas purchaser must offer to take federally-deregulated gas ratably from the wells which produce from a gas pool and, in the absence of an agreement as to price, must offer to pay the non-contract owners in the pool a market price for their gas constitute a burden on interstate commerce? If so, is the burden excessive in relation to the putative local benefits? No. That precise question was answered thirty-five (35) years ago in *Peerless,* which rejected the claim that a state ratable take order violates the Commerce Clause. *Northern Natural,* decided on narrow statutory grounds, noted that *Peerless* remained good law as to the constitutional challenges to a state ratable take order. *Stare decisis,* however, is not the only reason why the state action at issue does not violate the Commerce Clause. Mississippi's ratable take requirement is an evenhanded measure taken to effectuate legitimate state interests, with any burden on interstate commerce being incidental or minimal. The most that can be said is that, on a purely hypothetical basis there might at *some* point be *some* incidental and as yet undefined effect on interstate commerce but, given the strong legitimate state interests and local benefits sought to be effected by the state requirement, the possibility that an incidental effect might be felt somewhere by someone does not rise to the level of a prohibited "excessive" burden on interstate commerce, if a burden at all. *Peerless, supra; Pike* v. *Bruce Church, Inc.,* 397 U.S. 137, 142 (1970); *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service*

Commission, 461 U.S. 375 (1983); *Pacific Gas & Electric Co.* v. *State Energy Resources Conservation & Development Commission*, 461 U.S. 190 (1983).

ARGUMENT

I.

MISSISSIPPI'S RATABLE TAKE REQUIREMENT IS NOT PREEMPTED

The Mississippi ratable requirement at issue is not preempted by either the NGA or the NGPA, for at least three (3) reasons. First, the pervasive scheme of federal regulation, which was perceived to exist when *Northern Natural* was decided, no longer exists. Congress has expressly declared that the first sale/purchase of deregulated natural gas is free from federal regulation under both the NGA and the NGPA, and Congress has not prohibited the States from once again regulating what the federal government has ceased to regulate. Second, there is no actual or theoretical conflict between the wellhead transaction affected by the state requirement and the subsequent transportation and resale activities which the FERC regulates on a modified basis. It is possible for Transco to comply with both the state requirement and the applicable federal regulations. Third, the state requirement does not frustrate or stand as an obstacle to the purposes and objectives of the NGPA. The primary objective of the NGPA is to make *more* new gas available to the interstate market and allow producers who sell in interstate commerce the opportunity to receive a fair market price for their new gas. That is what—and all—that the state requirement at issue has effected: An opportunity for the owners in a pool to sell their new gas in interstate commerce at a fair market price.

There are three (3) ways in which state law can be preempted by federal law: First, Congress may explicitly define the extent to which it intends to preempt state law. *Michigan Canners and Freezer Association, Inc.* v. *Agri-*

culture Marketing and Bargaining Board, —— U.S. ——, 104 S.Ct. 2518 (1984). "[A] federal decision to forego regulation in a given area may imply an authoritative federal determination that the area is best left unregulated, and in that event would have as much pre-emptive force as a decision to regulate." *Arkansas Electric Cooperative Corporation* v. *Arkansas Public Commission, supra.* This requires an affirmative statement by Congress that neither the States nor the Federal Government is to regulate an activity or area. *Id; Pacific Gas & Electric Co.* v. *State Energy Resources Conservation and Development Commission, supra.* Second, Congress may indicate an intent to occupy an entire field of regulation, in which case the States must leave all regulatory activities in that area to the federal government. *Michigan Canners, supra.* This requires a showing of a "scheme of federal regulations so pervasive as to make reasonable the inference that Congress left no room to supplement it." *Pacific Gas and Electric Co., supra; Silkwood* v. *Kerr-McGee Corp.,* —— U.S. ——, 104 S.Ct. 615, 621 (1984). Third, if Congress has not displaced state regulation entirely, it may nonetheless preempt state law to the extent that the state law actually conflicts with federal law. Such a conflict arises when compliance with both state and federal laws is possible, or when the state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress. *Michigan Canners, supra; Silkwood, supra,* 104 S.Ct. at 621.

The state ratable take requirement at issue clears all of these hurdles.

1.

There Is No Express Preemption

Congress has not made an express authoritative determination that federally-deregulated wellhead sales of natural gas are to be left unregulated by the States. The test is not, as Transco suggests, whether Congress has affirma-

tively *granted* the States the authority to regulate these wellhead sales; rather, it is whether Congress has affirmatively declared that these sales are *not* to be regulated by the States. *See Arkansas Electric Cooperative Corporation, supra,* 103 S.Ct. at 1912; *Pacific Gas and Electric Co., supra,* 103 S.Ct. at 1722; *Hayfield Northern Railroad Co., Inc.* v. *Chicago and North Western Transportation Co.,* —— U.S. ——, 104 S.Ct. 2610, 2614 (1984).

Nothing in the language, history or policy of the NGPA suggests such a conclusion.* For example, NGPA Sections 503 and 602, 15 U.S.C. §§ 3413 and 3432, provide express authority for the States to take steps to classify wells and set lower maximum lawful prices. *See Energy Reserves Group, Inc.* v. *Kansas Power & Light Co.,* 459 U.S. 400 (1983). Obviously, Congress contemplated that the States would not be preempted from reasserting a regulatory presence in the area of wellhead sales of federally-deregulated natural gas. Thus, as even the FERC concedes (FERC's Brief at p. 15), there is no language in the NGPA or its legislative history which states that the States may not reasonably regulate what the FERC can no longer regulate. Accordingly, the State is not expressly preempted from acting. *See,* e.g., *Pacific Gas & Electric Co., supra; Hayfield Northern Railroad Co., Inc., supra.*

2.

There Is No Implied Preemption

Preemption may be implied from a pervasive scheme of federal regulation. The NGPA, however, has eliminated whatever pervasive scheme of federal regulation provided the rationale in *Northern Natural* for this Court to invalidate a state ratable take order. There is no actual or theoretical conflict between the wellhead transaction af-

---

* *See, e.g.,* 124 Cong. Rec. 29099-29109 (9-13-78); 124 Cong. Rec. 30011-30035 (9-19-78).

fected by the State, and the subsequent transportation and resale activities which the FERC regulates on a modified basis.

The corresponding section of Transco's brief to which we now respond is a remarkable work of intellectual dishonesty: Transco does not even pause to cite *the* case or discuss *the* statute or mention *the* Congressional conference report which are controlling of the federal preemption issue. The omitted case is *Peerless, supra;* the undiscussed statute is Section 601(a)(1) of the NGPA; and the unmentioned report is *the* "Joint Explanatory Statement of the Committee on Conference" of the Congress which accompanied the NGPA and explained the meaning and intent of § 601(a)(1). The first upheld a very similar ratable take/non-discriminatory purchase order directed against an interstate gas pipeline prior to *Northern Natural;* the second and third make it clear that Congress, by deregulating this gas and providing that a wellhead sale of deregulated gas is no longer subject to FERC's jurisdiction under the NGA, rendered both the rationale and the rule of *Northern Natural* inapplicable to the first sale/purchase of deregulated gas.[10]

How did we come to this point? By two roads. First, down a road of NGA/FERC regulation of the first sale transaction between a producer and an interstate gas purchaser, a comprehensive regulation which resulted in artificially low NGA-mandated "just and reasonable" wellhead prices, low prices which created disincentives for producers to drill for new gas and sell that gas into interstate commerce, a lack of incentive which ultimately led to the severe interstate gas shortages of the mid-1970s,

---

[10] The gas in question is both deregulated gas, meaning that it has been classified as "deep, high-cost gas" under NGPA Section 107(c)(1), and undedicated gas, meaning that it was not committed or dedicated to interstate commerce on the day before the date of enactment of the NGPA. See NGPA Section 601(a)(1).

shortages which have been described as a "national crisis." That is the same road which led to the *Phillips* decision in 1954 and to *Northern Natural* in 1963.

The nation's recovery from that abysmal situation began in 1978 when Congress turned down a second road, a road of NGPA regulation-to-deregulate which eliminated the difference between the interstate and intrastate markets, and provided producers and interstate gas purchasers alike with the degree of freedom from federal regulation and with the price incentives which Congress determined were needed in order to allow the price of gas *to rise* and encourage producers to discover and produce new gas and sell that gas in the interstate market. NGPA Section 601 (a)(1) was the means used to eliminate federal regulation of the first sale and purchase of certain types of natural gas, including the gas at issue. It is the elimination of that federal regulation which has freed the State, once again, to attach a simple ratable take requirement to the first sale and purchase of federally-deregulated gas. The State's authority to make that type of requirement was recognized by this Court thirty-five (35) years ago in *Peerless*.

Peerless

The producer in *Peerless* found itself in virtually the same quandary as did Coastal: The interstate gas purchaser who was buying from the pool first refused to buy Peerless' gas at all, and then offered to buy the gas at a price which was lower than that being paid to other owners in the field. The state conservation commission then entered a ratable take order requiring the purchaser to take gas ratably from the pool and to pay Peerless a fixed minimum price. This Court, in a unanimous decision, rejected challenges to the order made on the grounds of the Due Process, Equal Protection and Commerce Clauses.[11]

---

[11] In a companion case to *Peerless*, *Phillips Petroleum Co.* v. *Oklahoma*, 340 U.S. 190 (1950) the Court upheld a similar minimum price order issued by the Oklahoma Corporation Commission.

In *Peerless,* however, the Court made the cryptic observation that it was not considering the effect the NGA might have on a state ratable take order. That effect was considered thirteen years later in *Northern Natural,* which was decided after the 1954 decision in *Phillips.*

Phillips

At the time *Peerless* was decided, the NGA had not been construed to apply to the first sale transaction between a producer and an interstate gas purchaser. Four (4) years later, however, the Court's decision in *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672 (1954) extended the NGA, and the FPC's jurisdiction thereunder, to cover a producer's sale of gas to an interstate pipeline, thus allowing the FPC to determine, *inter alia,* whether gas could be sold into interstate commerce and whether the sales price was "just and reasonable." Distinguishing *Peerless,* the Court reiterated the aim of the NGA:

> "Protection of consumers against exploitation at the hands of natural-gas companies was the primary aim of the Natural Gas Act. * * *"

347 U.S. at 685.

Phillips launched a twenty-five (25) year period during which the FPC (later FERC) under Section 1(b) of the NGA, controlled all facets of producers' sales and interstate pipelines' purchases of gas. The "red tape" was so burdensome and the "just and reasonable" prices set by the FPC were so artificially low that, as the years passed by, the prices provided little or no incentive for producers to develop new gas reserves and sell that gas into the interstate market. The "pay-off" for this scheme of federal regulation was a severe shortage of gas on the federally-regulated interstate market, while the *state*-regulated intrastate market enjoyed an abundance of gas.

Northern Natural

Northern Natural was an extension of *Phillips'* holding that wellhead sales of gas in interstate commerce were within the scope of § 1(b) of the NGA, and *Phillips'* philosophy that consumers should be protected from higher gas prices. The Court, with Harlan, Stewart and Goldberg dissenting, and White, not participating, held invalid a ratable take order which the Kansas Corporation Commission entered against an interstate pipeline company, because the state order invaded what was *then* the FPC's exclusive regulatory jurisdiction under Section 1(b) of the Natural Gas Act of 1938 (NGA):

> "We disagree with the Kansas Supreme Court, for we hold that the State Commission's order did invade the exclusive jurisdiction which the Natural Gas Act has conferred upon the Federal Power Commission over the sale and transportation of natural gas in interstate commerce for resale."

372 U.S. at 89. The limited statutory basis for the result in *Northern Natural* is evidenced by the fact that the Court was careful to point out that it was not overruling *Peerless.*[12] Thus, the state order was invalidated on a narrow statutory ground because of the "imminent possibility of conflict" with the FPC's then existing exclusive jurisdiction[13] under Section 1(b) of the NGA, *inter alia,*

---

[12] 372 U.S. at 91, note 10. Peerless was most recently cited in a NGPA context in *Energy Reserves Group, Inc.* v. *Kansas Power & Light Co.*, 459 U.S. 400 (1983). There, the Court cited *Peerless* for its holding that a state has the power to regulate natural gas prices and sales so long as that regulation does not interfere with the Commerce Clause. *Id.* at notes 16 & 17. Other decisions have reaffirmed the continuing validity of *Peerless. See, e.g. Sporhase* v. *Nebraska,* 458 U.S. 941, n. 16 (1982); *Cities Service Co.* v. *FEA,* 529 F.2d 1016, 1027 (T.E.C.A. 1975); *Chevron Chemical Co.* v. *Castle,* 641 F.2d 104, 116 (3rd Cir. 1981).

[13] The Court in *Northern Natural* stated that with respect to the NGA, "[t]he Congress enacted a comprehensive scheme of fed-

to grant or deny the entry of gas into the interstate market, and to fix the "just and reasonable" wellhead sale price of that gas. It was precisely that jurisdiction which was eliminated by NGPA Section 601(a)(1).[14]

The NGPA

To represent that the NGPA merely extended federal regulation to all gas in order to "totally regulate" the natural gas industry is to seriously distort the expressed meaning and intent of the NGPA, and is to give the Court no idea of why federal regulation was initially extended and for what ultimate purpose. To answer those questions is to supply the reasons why Section 601(a)(1) was included in the NGPA and why the State may now attach the ratable take requirement at issue to *any* purchaser's takes of federally deregulated gas.

---

eral regulation of 'all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company,' " 372 U.S. at 91. Compare that pre-NGPA view with the Court's post-NGPA view of the scheme of federal regulation, stated in *Public Service Commission* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983):

> "The NGPA is designed to preserve the Commission's authority under the NGA to regulate natural gas sales from pipelines to their customers; however, *it is designed to supplant the Commission's authority to establish rates for the wholesale market, the market consisting of so-called 'first-sales' of natural gas.*" [Emphasis added].

[14] In *Northern Natural*, the Court also noted that "[p]ersistent efforts to narrow the scope of the broader exclusive federal jurisdiction conferred by the [NGA] have been unavailing." 372 U.S. at 91, note 9. Those efforts continued, however, and ultimately culminated in passage of the NGPA and the inclusion of § 601 therein which altogether eliminated FERC's jurisdiction under the NGA over the first sale of certain categories of natural gas, such as § 107 gas.

The purpose of the NGPA was not to extend federal regulation for the simply joy of regulating nor to ensure a supply of "cheap gas." The NGA policy of regulation-for-cheap gas ultimately led to the severe shortages of gas in the interstate market in the 1970s which in turn prompted passage of the NGPA as a solution to those shortages.

Why Did Congress Include Section 601 in the NGPA?

The NGPA in general, and Section 601 in particular, was enacted in large part to eliminate those NGA regulatory features which had actively discouraged producers from selling new gas into the interstate market and had seriously handicapped interstate pipeline purchasers, like Transco, in their attempts in the late 1970s to purchase new gas for the interstate market to meet the then serious shortfall of gas in that market.

Prior to the enactment of the NGPA, two NGPA regulatory features actively discouraged producers from selling new supplies of natural gas into interstate commerce: (1) The literal regulatory maze which a producer and a pipeline had to go through and comply with before a pipeline could even purchase gas for the interstate market, and (2) extremely low NGA-mandated and FERC-determined "just and reasonable" ceiling prices which a pipeline could pay a producer for gas.

The extent of the FERC's pre-NGPA *total* control over all aspects of the producer/pipeline sale and purchase of gas can be appreciated by an examination of the FERC's pre-NGPA/NGA-power to grant or deny a certificate of public convenience and necessity. Under the NGA, gas could not even lawfully enter the interstate market unless the FERC first issued a certificate of public convenience and necessity. The FERC would not issue the required certificate unless the producer-pipeline contract contained certain price limitation clauses and excluded other types

of clauses.[15] Thus, through its power to grant or deny the required certificate of public convenience and necessity, the FERC was able to *directly* dictate the contract terms and price which a pipeline could pay and a producer could receive.

It was because of these discouraging features of the NGA and the FERC's regulatory powers under the NGA that producers began selling their gas in the intrastate market (they didn't have to deal with the NGA or the FERC, and they could get a much higher price) and, concomitantly, pipelines like Transco were unable to purchase gas for the interstate market. By the late 1970s, the "cause and effect" finally culminated in severe gas shortages in the interstate market, while at the same time there existed an abundance of higher priced gas in the intrastate market. That "national problem" of gas shortages in the interstate market was *the* reason why Congress passed the NGPA.[16]

In enacting the NGPA, Congress had two central goals: First, to provide price incentives to producers to drill more gas wells, find new gas and put that new gas into the interstate market. Second, to free producers and pipelines

---

[15] *See, e.g.*, 18 C.F.R. Sections 154.39 and 154.103. *See also* the "Curtis/Jackson Letter" of September 8, 1978 which appears as part of the legislative history of the NGPA: "At present, the Commission's existing certification procedures entail an examination of whether the proposed contract conforms with the Commission's price regulations. As a result of this review, the Commission's certificate is typically conditioned to eliminate or modify contractual provisions which would operate to yield a price in excess of that demand just and reasonable . . . . [T]he NGA authorization for these controls would cease under the NGPA . . . ." Federal Programs Advisory Service [FPAS] § 601:220, pg. 3.

[16] *See, e.g., Tenneco, Inc.* v. *Sutton, supra*, 530 F.Supp. at 418, notes 24 & 25, at 420-21; *Mid-Louisiana Gas Co.* v. *FERC*, 664 F.2d 530, 533 (5th Cir. 1982); *Pennzoil Co.* v. *FERC, supra*, 645 F.2d at 367, n. 13.

from those regulatory features of the NGA and the FERC's jurisdiction which were discouraging producers from selling gas to the pipelines and were crippling pipelines' ability to purchase new gas.[17]

Those congressional goals were reached by Congress first, extending federal regulation to intrastate gas in order to eliminate the price discrepancies then existing between the intrastate and interstate markets; second, eliminating the FERC's NGA-jurisdiction and powers to require a producer and a pipeline to obtain the FERC's approval of the entry of new gas into the interstate market and the price to be paid by the pipeline for that gas; and third, enacting fairly immediate price deregulation for some new gas ("high-cost gas" under Section 107), and gradual price deregulation for other new gas (such as gas under Sections 102 and 103). Sections 121 and 601 of the NGPA accomplished the later two of these goals.

Section 121 provided producers with the price incentives needed to encourage them to find new gas and sell that gas into the interstate market. Thus, Section 121 eliminated price controls for Section 107 "high-cost gas" (as of November 1, 1979) and set a January 1, 1985 date for price deregulation of other new gas, such as gas qualifying under Sections 102 and 103. Section 121 thus furnished *the price incentives* which Congress intended.

Section 601 provided producers and pipelines with the freedom from regulatory interference by the FERC with a pipeline's purchase and a producer's sale of new gas

---

[17] *See, e.g., Pennzoil Co.* v. *FERC*, 645 F.2d at 378: "The NGPA is a fundamental change in regulatory outlook. * * * FERC has a fundamentally different regulatory obligation. . . . The balance Congress struck already took into account the conflicting interests of producers and consumers." In *Pennzoil*, the Court concluded that the effect of § 601(a)(1)(A) was to deny FERC the authority to regulate or interpret gas purchase contracts covering "undedicated" gas. *Id.* at 380. *See also Mid-Louisiana Gas Co.* v. *FERC*, 664 F.2d at 530, 535 (5th Cir. 1981); Williams, *supra*, note 5.

in order to enable a pipeline to freely compete for new gas by allowing the pipeline to pay a producer the higher incentive prices or deregulated prices for new gas (without *ever* having to get FERC approval of the prices paid or the other terms of the contract), and to exempt a pipeline and a producer alike from the then existing regulatory constraints of the NGA and the FERC's jurisdiction under the NGA, constraints which had combined with low FERC-set "just and reasonable" prices to produce the severe gas shortages of the late 1970s caused by the producers' reluctance (and sometimes refusal) to sell their gas to interstate commerce, and the pipelines' inability to buy new gas from the producers. Section 601 thus furnished the pipelines and the producers with *the degree of freedom from regulatory interference* by the FERC which Congress intended.[18]

Section 601(a)(1)

We will not mince words: If the "first sale" (the well-head sale) of deregulated gas[19] continues to be subject to

---

[18] *See, e.g., Tenneco* v. *Sutton*, 530 F.Supp. 411, 419 (M.D. 1981): "These provisions [Section 601] remove the Commission's authority to establish just and reasonable prices under the NGA for producer sales into the interstate market and to indirectly regulate these sales through control of the interstate pipeline purchaser's pass-through of purchase gas costs." *See also* the "Curtis/Jackson Letter", FPAS § 601:220 (9-8-78), on Section 601: "This section [601] executes the legislative intent to remove from Natural Gas Act utility type regulation natural gas not heretofore dedicated or committed to interstate commerce (§ 601(1)(1)(A), and to remove from Natural Gas Act-type regulation heretofore jurisdictional sales of high cost gas, gas from new OCS leases, new well qualifying for the new natural gas price under section 102, and [103 gas] (§ 601(a)(1)(B)." FPAS § 601:220, page 2.

[19] The gas in question is both *deregulated gas* (meaning that it has been classified as "deep, high-cost gas" under NGPA Section 107(c)(1) and *undedicated gas* (meaning that it was not committed or dedicated to interstate commerce as of the day before the date of the enactment of the NGPA).

the FERC's jurisdiction under Section 1(b) of the NGA, then *Northern Natural* applies to this case and Order No. 409-82 is invalid. However, if the FERC's jurisdiction under Section 1(b) of the NGA no longer applies to the first sale of deregulated gas, then *Northern Natural* cannot apply to this case and Order No. 409-72 is as valid and enforceable as was the same type of state order in *Peerless*.

Clearly, under NGPA § 601(a)(1)(A) and (B), the first sale and purchase of deregulated gas is no longer subject to either the NGA or the FERC's NGA jurisdiction. Congress has specifically declared that the first sale of deregulated gas is *never* made subject to the NGA or the FERC's jurisdiction under the NGA, and "dedicated gas" which is determined to be also deregulated gas *ceases* to be subject to the NGA and the FERC's jurisdiction under the NGA.

NGPA Section 601(a)(1)(A), (B) and (D), 15 U.S.C. § 3431(a)(1)(A), (B) and (D), provide as follows:

> SECTION 601. COORDINATION WITH THE NATURAL GAS ACT—
>
> (a) JURISDICTION OF THE COMMISSION UNDER THE NATURAL GAS ACT.—
>
> (1) SALES.—
>
> (A) NATURAL GAS NOT COMMITTED OR DEDICATED—
>
> *For purposes of section 1(b) of the Natural Gas Act*, effective on the first day of the first month beginning after the date of the enactment of this Act, *the provisions of the Natural Gas Act and the jurisdiction of the Commission under such shall not apply to natural gas which was not committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act* solely by reason of any first sale of such natural gas.

(B) COMMITTED OR DEDICATED NATURAL GAS—

Effective beginning on the first day of the first month beginning after the date of the enactment of this Act, *for purposes of section 1(b) of the Natural Gas Act, the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act and which is—*

(1) *High-cost natural gas* (as defined in Section 107(c)(1), (2), (3), or (4) of this Act);

• • •

(D) NATURAL GAS COMPANY—For purposes of the Natural Gas Act, the term "natural gas comapny" (as defined in section 2(6) of such act) *shall not include any person by reason of, or with respect to, any sale of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission do not apply to such sale solely by reason of subparagraph (A), (B) or (C) of this paragraph.* [Emphasis added].

The "Joint Explanatory Statement of the Committee on Conference" of the Congress, which accompanied the NGPA, is extremely important because it states in plain English what Section 601(a)(1) means:

"The conference agreement limits the jurisdiction of the Commission under the Natural Gas Act in a manner similar to the House-passed bill.

Natural gas not committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act is never made subject to the Commission's jurisdiction under sec. 1(b) of the Natural Gas Act. The Commission's jurisdiction under section 1(b) of the Natural Gas Act ceases on the first day of the first month beginning after the date of enactment of this Act for the following categories of natural gas:

> *High-cost natural gas* which qualifies for deregulated price treatment under the section 107(c)(1), (2), (3), or (4); [Emphasis added].

Section 601(a)(1) means what it says—the Natural Gas Act of 1938 (NGA) and FERC's jurisdiction under the Act *never* apply to deregulated gas, and certain other categories of gas.[20]

Analysis of Section 601

Under the Section 601 statutory scheme,[21] Section 601 (a)(1) removes the FERC's NGA-jurisdiction to directly or indirectly control or regulate a pipeline's purchase of deregulated gas and the price paid by the pipeline for that

---

[20] *See Pennzoil Co.* v. *FERC,* 645 F.2d 360, 380 (5th Cir. 1981): "NGPA § 601(a)(1)(A) further provides that gas which on November 8, 1978, was not committed or dedicated to interstate commerce is exempt from NGA jurisdiction effective December 1, 1978, even if it is therefore sold in interstate commerce. *In other words, section 601(a)(1)(A) prevents the universe of gas subject to the NGA from expanding.*" [Emphasis added] The court held that, because of Section 601(a)(1)(A), FERC never has jurisdiction to regulate or interpret gas purchase contracts covering undedicated gas.

[21] *See, e.g., Tenneco, Inc.* v. *Sutton, supra,* 530 F.Supp. at 419: "These provisions [Section 601] remove the Commission's authority to establish just and reasonable prices under the NGA for producer sales into the interstate market and to indirectly regulate these sales through control of the interstate pipeline purchaser's pass-through of purchase gas costs." *See also* the "Curtis/Jackson Letter", *supra,* on Section 601: "This section [601] executes the legislature intent to remove from Natural Gas Act utility type regulation natural gas not heretofore dedicated or committed to interstate commerce (§ 601(a)(1)(A), and to remove from Natural Gas Act-type regulation heretofore jurisdictional sales of high cost gas, gas from new OCS leases, new well qualifying for the new natural gas price under Section 102, and [103 gas] 601(a)(1)(B)." FPAS 601: 220, page 2.

gas. In place of that "lost" jurisdiction over the pipeline's purchases of that gas, Section 601(c) gives the FERC the jurisdiction and power to deny a pipeline pass-through of the price the pipeline pays for deregulated gas, but *only* if the FERC can prove that the price results from "fraud, abuse or similar grounds." Moreover, the FERC's power to deny a pipeline a pass-through can be exercised *only* against the pipeline and *only* when (and if) the pipeline comes before the FERC to obtain authority to pass-through the entire price paid by the pipeline and include that price in the resale rates charged by the pipeline to consumers. However, the FERC still has no authority or jurisdiction (not even under Section 601(c)) to regulate or control a pipeline's purchase of deregulated gas, or the price which the pipeline pays to producers or the pipeline's contract with the producers.

Our inquiry into "why did Congress include Section 601" merits a brief sub-section by sub-section analysis of just how Congress used Section 601 to free the producers and pipelines from the NGA and FERC's NGA-jurisdiction to control purchases, sales, contract terms and prices paid by pipelines for deregulated gas.

First, Congress included Section 601(a)(1) to eliminate the NGA requirement that the parties had to first obtain from the FERC a certificate of public convenience and necessity as to new gas, and to remove the FERC's jurisdiction and power to set a "just and reasonable" price and dictate contract terms. Section 601(a)(1) provides that the first sale of undedicated gas is never made subject to the NGA or the FERC's NGA-jurisdiction.[22] The *effect* of this particular sub-section is that neither the producer nor the pipeline ever has to obtain the previously required certificate of public convenience and necessity in order to

---

[22] NGPA § 601(a)(1)(A)(B), 15 U.S.C. § 3431; Joint Explanatory Statement of the Committee on Conference of the Congress. *Accord, Pennzoil Co.* v. *FERC, supra,* 645 F.2d at 380.

sell and buy this type of new gas.[23] Because the parties do not have to obtain a certificate from the FERC, the FERC cannot use its NGA power (to grant or deny a certificate) to control purchases, contract terms and price, as it did prior to enactment of the NGPA.[24] Nor can the FERC, pursuant to its NGA jurisdiction over a "natural gas company," control the price which a pipeline like Transco pays for the gas on the grounds that Transco is an otherwise regulated "natural gas company." Section 601(a)(1)(D) takes care of that potential problem by providing that Transco shall not be considered to be a "natural gas company" with respect to its purchase of deregulated gas.

Second, Congress included Section 601(b) and (c) to protect a pipeline from an after-the-purchase attack by

---

[23] *See, e.g., Conoco, Inc.* v. *FERC*, 622 F.2d 796 (5th Cir. 1980). *See also* FERC's Preamble to the issuance of the first interim regulations issued after the NGPA was passed, 43 F.R. 56448 (12-1-78), wherein FERC observed the effect of the NGPA on the NGA:

> "The new law affects sales, transmission and distribution of natural gas. The previously controlling federal regulatory statute, the Natural Gas Act (NGA) has in many respects been limited, replaced or superseded by the NGPA . . . ." (*Id.* at 56451).
>
> "If gas is not committed or dedicated to interstate commerce . . . or is exempted from the jurisdiction of the NGA under section 601(a)(1)(B) as [107 or 102 or 103 gas] the prior framework of utility-type regulation under the NGA no longer applies."
>
> "If natural gas sales are freed from the requirements of the NGA, several adjuncts to NGA regulation are obviated. First, there is no longer any necessity for a producer to seek certification of the sales as serving the public convenience and necessity." *Id.* at 56455.

[24] *See, e.g., Pennzoil Co.* v. *FERC, supra*, in which the Fifth Circuit held that FERC no longer has jurisdiction to regulate or interpret gas purchase contracts covering undedicated gas or dedicated gas which is also 107 or 102 or 103 gas: "In other words, section 601(a)(1)(A) prevents the universe of gas subject to the NGA from expanding." 645 F.2d at 380.

the FERC on the price which the pipeline pays for deregulated gas. Section 601(b) provides that all prices which the pipeline pays for deregulated gas are deemed "just and reasonable" as a matter of law, and Section 601(c) provides that the pipeline has the guaranteed right to pass-through the price which it pays for deregulated gas and include that price in its resale rates charges to consumers.[25]

A pipeline can be denied its guaranteed statutory right to pass-through the price paid to producers *only* if the FERC finds that the price results from "fraud, abuse or similar grounds." *See* Section 601(c)(2). That particular determination can be made *only* in rate proceedings before the FERC in which the pipeline seeks authority to pass-through the deregulated price and include the price in its resale rates to consumers. The FERC can deny the pipeline a pass-through of *only* that portion of the deregulated price which results from "fraud, abuse or similar grounds." However, the FERC still has no jurisdiction or authority to prevent the pipeline from purchasing deregulated gas or paying deregulated prices to the producers.[26]

The practical effect of Section 601(a)(1) is that the FERC cannot prevent, regulate or control a pipeline's purchases and takes of deregulated gas nor the price which the pipeline pays for that gas; the FERC cannot directly or indirectly regulate, control or dictate the contractual

---

[25] *See, e.g., Pennzoil Co.* v. *FERC*, 645 F.2d 360, 379 (5th Cir.): "Section 601(c)(2) guarantees to interstate pipelines the ability to pass through NGPA payments." *See also* FERC's preamble to its interim regulations under the NGPA, 43 F.R. 56448, 56456 (12-1-78).

[26] In this regard, many contracts in industry use for years provide that, if FERC denies a pipeline the right to pass-through all or part of the contract price, that denial gives the purchaser the right to cancel the contract. But the pipeline may elect to keep the contract in effect by continuing to pay the contract price even though the pipeline is not able to pass-through the entire contract price in its resale rates.

terms on which the gas is to be sold and purchased; the pipeline and the producer do not ever have to obtain the FERC's approval of the price paid by the pipeline; and the pipeline and the producer do not ever have to obtain a certificate of public convenience and necessity from the FERC in order for the pipeline to be able to buy the gas and bring it into the interstate market.

Section 601(a)(1), therefore, is controlling of the preemption question in this case. The reason this Court voided the ratable take order in *Northern Natural* was because at that particular point in time such an order was perceived to substantially affect an area (wellhead sales) which was subject to the FPC's jurisdiction under the NGA. If the NGA and the FERC's jurisdiction under the NGA no longer apply to the wellhead sale and purchase of deregulated gas, and the FERC has no authority to regulate the first sale and purchase of deregulated gas, either directly or indirectly, then *Northern Natural* does not preempt the otherwise existing authority which the States have to require a gas purchaser to offer to take gas ratably and, in the absence of an agreement, pay a market price. *Peerless.*

3.

There Is No Conflict Between Mississippi's Ratable Take Requirement and the NGA/NGPA

Obviously, the NGPA regulatory scheme is vastly different from the NGA regulatory scheme which prevailed when *Northern Natural* was decided. There *now* is neither an actual nor a hypothetical conflict between the state ratable take requirement at issue and, on the other hand, the NGA and the NGPA.

To review, at the time *Northern Natural* was decided the FPC (now FERC) had two fundamental regulatory powers over gas which was destined for an interstate market. First, before the gas could even enter the interstate market, the producer and pipeline had to obtain a

certificate of public convenience and necessity from the FPC; they were not free to simply put the gas into the interstate market without FPC approval. Second, the price paid by the pipeline had to be first approved by the FPC as a "just and reasonable price"; the producer and pipeline were not free to negotiate a price. There were no ceiling prices as such, only "just and reasonable" prices, and there was no interstate gas which was not subject to federal price regulation.

That was the federal regulatory scheme with which the Kansas ratable take/minimum price order collided in *Northern Natural*. The order could interfere with *both* of what were *then* the FPC's fundamental regulatory powers because the order could force gas into interstate commerce, without a *then* required certificate of public convenience and necessity, and set a minimum price to be paid for the gas, without a *then* required adjudication by the FPC that the minimum price was "just and reasonable."

The NGPA fundamentally changed that regulatory scheme. First, a certificate of public convenience and necessity is no longer required before undedicated or deregulated gas can enter the interstate market; a producer and pipeline are free to put the gas into the interstate market at anytime. This, of course, is consistent with the overall goal of the NGPA—to get *more* gas into interstate commerce with less red tape. Second, the FERC has no jurisdiction over and no authority to set the "first sale" price to be paid by the pipeline for deregulated gas; under Section 601(b)(1)(A) the price paid by the pipeline for deregulated gas is presumed to be "just and reasonable" and no FERC approval is required before the pipeline can pay that price. Nor can the FERC seek to influence or affect the first sale price paid by the pipeline through the FERC's jurisdiction over the pipeline's resale rates; under Section 601(c), the pipeline has a guaranteed statutory pass-through of the price it pays for the gas, unless the price results from "fraud, abuse or similar grounds."

Thus, the state action at issue stops short of affecting any transaction which continues to be subject to the NGA and FERC's jurisdiction thereunder. The ratable take requirement affects only the first sale—it goes no further. It is a case of congruent state and federal regulation.[27] Where one stops the other starts and neither infringes upon the other. Thus, the State is free, once again, to attach the ratable take requirement at issue to an interstate pipeline's takes of federally-deregulated gas. *Peerless.*

Transco's efforts to equate Mississippi's ratable take requirement with the state action which was invalidated in *Maryland* v. *Louisiana,* 451 U.S. 725, 101 S.Ct. 2114 (1981), and in *Exxon Corp.* v. *Eagerton,* 103 S.Ct. 2296 (1983), is sophistry. Generically, those cases are "preemption cases," but they have *nothing* to do with deregulated gas, or, more importantly, Section 601(a)(1).

In *Maryland* v. *Louisiana,* Louisiana's "First Use Tax" provided for a tax on the first use of natural gas imported into Louisiana which was not previously taxed by another State or by the United States. The tax was designed to apply to gas produced off-shore from Louisiana and brought into the state. Louisiana law provided that the amount of the tax was to be deemed a "cost associated with uses made by the owner in preparation of marketing the gas" and further required that the tax must be born by either the owner of the gas or by the ultimate consumer. The Supreme Court held that the tax violated the NGA because the NGA gave the FERC the authority to determine the proper *allocation* of costs associated with the sale of natural gas to consumers and the Louisiana law directly inferfered with that authority because it attempted to dictate *to whom* the use tax would be *allocated.* The point: The NGA did apply to that gas and the Louisiana "First Use Tax" directly conflicted with the FERC's authority under the NGA to allocate costs in setting the resale price of gas sold in interstate commerce. *Maryland*

---

[27] *See,* Williams, *supra,* note 5.

v. *Louisiana* simply has no application to the particular federal preemption question now before this Court.

Exxon v. *Eagertown, supra,* was simply *Maryland* v. *Louisiana* with a twist. After the NGPA was passed, Alabama increased its severance tax on gas but prohibited producers from passing the tax increase through to consumers. The Supreme Court, citing *Maryland,* struck down the prohibition on the pass-through because it also "interfere[d] with the FERC's authority to regulate the determination of the proper allocation of costs associated with the sale of natural gas to consumers." 103 S.Ct. at 2303. In other words, the Alabama statute directly conflicted with the FERC's NGA authority to allocate costs in the *resale* of gas in interstate commerce.

Recent Supreme Court cases are more instructive of the power of the States to regulate against a background of federal regulation. In *Energy Reserves Group, Inc.* v. *Kansas Power & Light Co., supra,* an NGPA case, the Court upheld a state law providing for lower than maximum NGPA prices, citing *Peerless* for the proposition that the States could regulate natural gas prices provided they did not interfere with interstate commerce. 103 S.Ct. at 706, n. 16. In *Arkansas Electric Cooperative Corp., supra,* the Court held that the Arkansas commission's assertion of jurisdiction over the wholesale electric rates of a cooperative was not preempted by the Federal Power Act or the Rural Electrification Act. In *Pacific Gas & Electric Co., supra,* the Court upheld a state law which conditioned the construction of nuclear power plants on state funding of the availability of adequate storage facilities and means of disposal. *See also* the recent decisions in *Hillsborough County* v. *Automated Medical Laboratories, Inc.,* 53 L.W. 4612 (June 4, 1985), and *Metropolitan Life Insurance Co.* v. *Commonwealth,* 53 L.W. 4616 (June 4, 1985), upholding state and local regulatory acts carried out against a background of federal regulation.

In all of these recent cases, the Court refused to find state action preempted on the basis of mere hypothetical possibilities advanced by counsel. *Arkansas Electric Cooperative Corp., supra,* 103 S.Ct. at 1918; *Pacific Gas & Electric Co., supra,* 103 S.Ct. at 1729-30, 1731-32. That, of course, was precisely what Justice Harlan argued in his dissent in *Northern Natural.* 372 U.S. at 103-106.

Moreover, Mississippi's requirement does not frustrate or stand as an obstacle to the purposes and objectives of the NGPA. The overriding objective of the NGPA is to make more new gas available for sale in the interstate market at market prices. Mississippi's requirement fits congruently with that objective because it affords all of the owners of federally-deregulated gas in a pool the opportunity to offer their gas for sale in interstate commerce at a market price. The requirement nurtures the development of a competitive wellhead market and lower—not higher—market prices by affording more producers access to the market. Thus, more competition at the wellhead is the practical result.

Finally, in an attempt to bolster its claim of an actual conflict between Mississippi's ratable take requirement and the FERC's jurisdiction, Transco represents that the FERC has opened an "inquiry on possible discrimination of interstate pipelines in their purchasing practices." Transco's Brief at page 33. The FERC's silence on this point is deafening—the FERC's Brief does not so much as even mention the "inquiry," which is not even shown on the FERC's Semiannual Regulatory Agenda as being under consideration. *See* 49 F.R. 42418 (10-22-84). In fact, aside from one public meeting held two years ago, the FERC has not taken any further action in the docket, obviously because the FERC does not have any jurisdiction to directly or indirectly regulate an interstate pipeline's purchases and takes of deregulated gas in a first sale transaction.[28]

---

[28] In a related controversy, the FERC has declined to act on

II.

MISSISSIPPI'S RATABLE TAKE REQUIREMENT DOES NOT VIOLATE THE COMMERCE CLAUSE

Mississippi's ratable take requirement does not violate the Commerce Clause. First, the requirement effectuates legitimate state interests in protecting the coequal and correlative rights of the owners in a pool, affording each owner the opportunity to recover and sell his just and equitable share of gas from the pool, and treating the owners fairly. Second, the requirement applies evenhandedly to anyone who takes gas from a gas pool. Economic protectionism is neither the purpose nor the practical effect of the requirement. Third, whatever burden might be imposed on interstate commerce as a result of the requirement is incidental, if it exists at all.

This Court has held that a state ratable take/minimum price order entered against an interstate gas purchaser does not violate the Commerce Clause. *Peerless. Northern Natural* was careful to point out that *Peerless* remained good law. More importantly, however, since *Peerless* was decided this Court has formulated a new Commerce Clause test which has accorded the States a wider berth.

The modern Commerce Clause test is the balancing-of-interests test articulated in *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137 (1970):

---

various pipelines' requests for relief from contractual price and take-or-pay obligations which the pipelines, in hindsight, view as "uneconomic." The FERC has also told the Fifth Circuit that breach of contract suits brought by producers against their pipeline purchasers should not be referred to the FERC because FERC has yet to decide what, if any, jurisdiction it has over pipeline purchasing practices. *See In re Tenneco, Inc.*, No. 84-4074, Opening Brief of the FERC, submitted April 10, 1984. *See also* Moring, *A Quiet Revolution? The FERC Yields Pipeline Jurisdiction to the States and Courts*, Public Utilities Fortnightly at 36 (11-22-84).

> "[W]here [a] statute [regulation, rule or order] regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. • • • If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities."

397 U.S. at 142.

This modern test stands in stark contrast to the old, mechanical "bright line" test drawn in *Public Utilities Commission* v. *Attleboro Steam and Electric Co.*, 273 U.S. 83 (1927), and its predecessor cases, *Missouri* v. *Kansas Gas Co.*, 265 U.S. 298 (1924) and *Public Utilities Commission* v. *Landon*, 249 U.S. 236 (1919). The *Attleboro* test was, for all practical purposes, repudiated by this Court during its 1983 term:

> "We are faced, then, in this case, with precisely the question left open in *Illinois Gas:* Do we follow the mechanical test set out in *Attleboro*, or the balance-of-interests test applied in our Commerce Clause cases for roughly the last 45 years? • • • Thus, in recent years, this Court has explicitly abandoned a series of formalistic distinctions—akin to the one in *Attleboro*—which once both defined and controlled various corners of the Commerce Clause Doctrine. • • •
>
> The wholesale/retail line drawn in *Attleboro* is no less anachronistic than the rules we rejected in the cited cases. Moreover, we have had no occasion, since the 1930s, either to apply that line or to reject it in a case not governed by statute. The difficulty of harmonizing *Attleboro* with modern Commerce Clause doctrine has been apparent for a long time, so much so that we expressed skepticism about its continuing soundness as a constitutional, rather than statutory, rule in *Illinois Gas.*"

Arkansas Electric Cooperative Corp. v. *Arkansas Public Commission, supra,* —— U.S. at ——, 103 S.Ct. at 19160.

In recent years, the new balancing test under the Commerce Clause has been applied to accord the States a wider berth and uphold a wider variety of state regulatory activities which have been carried out against a background of federal regulation. *See* e.g., *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Commission, supra* (state commission could govern wholesale electric rates); *Minnesota* v. *Cloverleaf Creamery Co.,* 449 U.S. 456, 471-73 (1981) (state could ban sale of milk in plastic containers); *Reeves, Inc.* v. *Stake,* 447 U.S. 429, 443-47 (1980) (state could limit sale of state-controlled cement to residents); *Exxon Corp.* v. *Governor of Maryland,* 437 U.S. 117, 127-29 (1978) (state could mandate that oil producers not own retail outlets). *See also Commonwealth Edison* v. *Montana,* 453 U.S. 609, 624-29 (1981) (state could place exorbitant severance tax on coal); *Complete Auto Transist Co.* v. *Brady,* 430 U.S. 274, 288-89 (1977) (upholding a tax imposed by the state against an interstate trucking company for the privilege of doing business within the state).

1.

The Legitimate State Interests Supporting the Ratable Take Requirement

The interests sought to be effectuated by Mississippi's ratable take requirement have been reviewed and discussed at length earlier in this brief. *Supra* at pages 6-10, 14-15. These interests are undeniably legitimate and important.

2.

The Ratable Take Requirement Applies Evenhandedly

The uneven and discriminatory application of a state statute, order or regulation can be a form of economic pro-

tectionism. In *Arkansas Electric Cooperative Corporation, supra,* this Court identified economic protectionism as the most serious concern identified in *Pike.* Economic protectionism, however, is neither the purpose nor the practical effect of Mississippi's ratable take requirement.

Mississippi's ratable take requirement applies to *anyone* who purchases gas from a pool, whether a corporation or an individual, whether the purchaser hails from within or outside of Mississippi, and whether the purchaser is interstate or intrastate in character. Moreover, the requirement does not discriminate in favor of Mississippi production nor does it give Mississippi producers a larger share of any market. The requirement does not force or require Transco to take any set quantities of gas nor, for that matter, any gas at all. Transco, taking into consideration its market needs is free on even an ***hourly*** basis to take 100% of a pool's allowable, or 10%, or 1%, or none at all. All the State has required is that Transco offer to take *whatever* quantities of gas *Transco* decides it needs ratably from the wells producing from the pool.

The "practical effects" Transco and the FERC have dreamed up for purposes of their briefs are purely hypothetical possibilities which are not supported by any evidence in the record, nor by common sense. For example, Transco represents that "the practical result will be a significant increase in Mississippi purchases with a significant decrease in Transco's purchases from other states." (Transco's brief at page 39). Yet, there is not one word of evidence in the record to support this claim. There is no evidence of what additional quantities of gas, if any, Transco would have to take because of Mississippi's requirement, or whether that gas would displace any gas purchased outside of Mississippi. There is no evidence that Transco would have to take any greater quantities of gas from Mississippi as opposed to other states. It is just as

likely that now, as always, Transco takes more gas from other states than from Mississippi. Finally, there is no evidence that Transco has been prevented from taking less expensive gas because of Mississippi's requirement. Indeed, the irony of Transco's position is that the gas which Transco takes under Mississippi's ratable take requirement will be *less expensive* than the gas Transco wants to take under its contracts with the likes of Getty and Florida Exploration. The highly speculative nature of these alleged "practical effects" is underscored by the fact that since December 1982 Transco has continued to ratably take gas from the pool in question and pay a "market-out" price for the non-contract owners' gas.

All of this is to say that the burden created by Mississippi's ratable take requirement, if any, is not a burden on interstate commerce, but may be a burden on Transco. The ridiculous "practical effects" alleged by Transco are mere red herrings which have been dropped in order to divert the Court's attention from the fact that the only possible burden resulting from Mississippi's ratable take requirement is that Transco, because of some few contracts it freely agreed to with some few producers, possibly might have to reduce its takes of some of those producers' gas for an undetermined period of time, and might then incur an undetermined amount of contingent liability to make refundable take-or-pay payments to those few producers.

The speculative and isolated nature of any burden on Transco that might be an incident of Mississippi's requirement is revealed in Transco's framing of the Commerce Clause "question" in this case:

> "Does Mississippi's attempted regulation of interstate pipeline companies' purchase of "high-cost" gas constitute an impermissible burden on interstate commerce *under present market conditions?*" [Emphasis added]

This, of course, is a "weather vane approach" to the Commerce Clause: If the forecast is that compliance with

the state requirement might result in any kind of economic burden for Transco, then the requirement suddenly rises to the level of an excessive burden on interstate commerce. On the other hand, if there is no economic burden or risk for Transco, then there is no burden on interstate commerce. These type of individualized and seasonal burdens, however, are not what the Commerce Clause prescribes. Transco's fickle characterization of the Commerce Clause question in this case is directly attributable to the fact that, but for the temporary reduced demand for gas and those relatively few of Transco's gas purchase contracts in which Transco agreed to pay two or three times the market price for some gas and to make what it now regards as excessive take-or-pay payments, all without the protection of a market out clause, it would be convenient for Transco to comply with the State's ratable take requirement at issue. To paraphrase, there would be no burden on interstate commerce if Transco's "present market conditions" were "better." To indulge Transco's claim is to condition the State's exercise of its police powers on the happenstance and vagaries of the marketplace or the economic miscalculations of a party. It is to make the Commerce Clause trivial.

3.

Transco's Claim of Constitutional Regulatory Alternatives

This Court has repeatedly recognized the power of the States to enforce allowable orders so as to restrict the amount of natural gas produced and, therefore, the amount of natural gas which can be sold in interstate commerce. *See, e.g., Champlin Refining Co.* v. *Corporation Commission,* 286 U.S. 210 (1932).

The reason why Transco now touts the alleged regulatory alternative of an allowable order is Transco's self-

serving belief that Transco could wield such an order as a weapon to escape its contractual take-or-pay obligations to those producers with whom it has written contracts. As Transco candidly states in its brief:

> "A state can limit a local producer's right to produce more than his pro rata share of the available market for a common pool and effectively negate a purchaser's contract obligations in excess of that limit."

Transco's Brief at p. 47.

What is left unsaid by Transco is the fact that Mississippi law prohibits the State Oil and Gas Board from setting allowables according to market demand. Miss. Code Ann. § 53-1-1 states in relevant part:

> "It is not the intent nor the purpose of this law to require or permit the proration or distribution of the production of oil and gas among the fields and pools of Mississippi, on the basis of market demand. It is the intent and purpose of this law *to permit* each and every oil and gas pool in Mississippi to be produced *up to* its maximum efficient rate of production, subject to the prohibition of waste as herein defined, and further subject to the enforcement and protection of the co-equal and correlative rights of the owners of a common source of oil and gas, so that each, common owner may obtain his just and equitable share of production therefrom." [Emphasis added]

More to the point of the immediate discussion, however, Transco represents that an allowable order would be less burdensome on interstate commerce and, therefore, constitutional under the Commerce Clause. The illogic of this assertion is explained only by Transco's self-interest in trying to obtain such an order for use in attempting to escape its contractual take-or-pay obligations.

As Justice Harlan pointed out in his dissent in *Northern Natural,* an allowable order which limits the amount of

gas that can be taken by an interstate purchaser is as much of a "burden" on interstate commerce as is a ratable take order, if not a *greater* burden. The power of the States to control the amount of gas production through an allowable order which limits the amount of gas which can be produced presumes that a State can altogether curtail production, requiring a purchaser to look elsewhere to buy gas:

> "Indeed, the most direct interference with the availability of gas for interstate sale is the "allowable" order. It places a ceiling on the amount of gas that may be produced by a particular well during a given period of time and inevitably makes pipelines spread their demand among many wells. Obviously, its possible effect on cost is precisely the same as that which may be caused by a ratable order, for the two orders are merely variations of the same regulatory measure; both are designed to prevent the disproportionate taking of gas from some wells to the disadvantage of others."

372 U.S. at 104.

We strongly commend to the members of the Court a review of Justice Harlan's dissent in *Northern Natural*. His dissent has always made perfect sense, and even more so now that the wellhead sale of deregulated natural gas has been exempted from the FERC's jurisdiction under §1(b) of the NGA.

Mississippi's ratable take requirement is far less burdensome than the allowable order Transco wants. Mississippi's system of allowables sets a mere ceiling on production determined according to the maximum efficient rate of flow of the wells, and not according to a given pipeline's market demand. Once set, a well's allowable is a ceiling on production, not a floor. Transco is free to take any percent of the allowable, from 100% to zero, in order to meet its market needs. Transco can adjust its takes monthly, weekly, daily, hourly or by the minute. Transco decides how

much gas it needs and from what pools it will take gas. Transco can decide to take more gas from less expensive and older regulated pools, or any combination of takes it desires. In all of this, the State's requirement is so simple: If Transco decides to take gas from a pool of federally-deregulated natural gas, Transco must offer to take whatever quantities of gas it needs ratably from the wells and, in the absence of an agreement as to price, offer to pay a market price. That simple requirement is no burden on interstate commerce, much less an excessive burden.

Mississippi has not "interfered with the natural functioning of the market." (Transco's brief at p. 38.) What—and all—Mississippi has done is to put an end to Transco's patently unfair and ridiculously discriminatory takes of gas, in order to end the prospect of drainage, reservoir damage and abuse of the co-equal and correlative rights of the owners in a gas pool. If, by affording each owner in a pool a mere opportunity to sell his ratable share of a purchaser's gas needs at a mere market price, the State has interfered with what Transco calls the "natural functioning of the market," then it is indeed a perverse market that Transco has in mind, a market that was never envisioned by the framers of the Constitution. As Justice Jackson stated in *H. P. Hood & Sons, Inc.* v. *Dumond,* 336 U.S. 525 (1949):

> "Our system, fostered by the Commerce Clause, is that every farmer and every craftsman *shall be encouraged to produce by the certainty that he will have free access to every market in the nation,* that no home embargoes will withhold his export, and that no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any." [Emphasis added].

336 U.S. at 539.

CONCLUSION

Mississippi's simple ratable take requirement should be upheld because it does not actually or theoretically conflict with either the letter or the spirit of the NGA or the NGPA or the Commerce Clause. This requirement is so simple, so evenhanded, so fair, and so necessary in order to protect all owners in a pool—particularly the owners of small interests—from unratable takes, drainage and loss of their gas. What purchaser can reasonably complain about having to offer to pay a market price for whatever quantities of natural gas it needs if and when they are needed? The self-evident truths in that rhetorical question undergirth the reasonableness and constitutionality of Mississippi's ratable take requirement.

The decision of the Mississippi Supreme Court should be affirmed.

Respectfully submitted,

GLENN GATES TAYLOR
(Counsel of Record)
COPELAND, COOK, TAYLOR & BUSH
Suite 112 Capital Towers
Post Office Drawer 2132
Jackson, Mississippi 39225
(601) 354-0123

KENNETH I. FRANKS
JAMES RUSSELL TUCKER
HEIDELBERG, WOODLIFF & FRANKS
Suite 1400 Capital Towers
Jackson, Mississippi 39201
(601) 948-3800

Attorneys for Coastal Exploration, Inc.

July 19, 1985

Supreme Court, U.S.
FILED
OCT 1 1985
JOSEPH F. SPANIOL, JR.
CLERK

No. 84-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

APPELLANT'S REPLY BRIEF

JOHN MARSHALL GROWER
(*Counsel of Record*)
JEFFERSON D. STEWART
R. WILSON MONTJOY II
BRUNINI, GRANTHAM, GROWER & HEWES

R. V. LOFTIN, JR.
THOMAS E. SKAINS
DAVID A. GLENN
TRANSCONTINENTAL GAS PIPE LINE CORPORATION

Attorneys for Appellant

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

BEST AVAILABLE COPY

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
I. PREEMPTION	1
A. The Arguments Against Preemption are Fatally Flawed	1
1. Partial Wellhead Deregulation under the NGPA has not created a regulatory gap which Congress intended the states to enter	2
2. Section 601(a)(1) has not affected interstate pipeline regulation	3
3. A pipeline's purchase cannot be regulated by the state without conflicting with FERC's regulation of interstate transportation and sales	4
B. The Preemption Cases Dealing With Other Federal Legislation Have No Precedential Value	8
II. COMMERCE CLAUSE	10
A. The "Practical Effect" of Rule 48 is to Both Burden and Discriminate Against Interstate Commerce	10
B. The Interests of Fairness Are Not Promoted by Rule 48	13
C. *Peerless* Does Not Support Rule 48	17
D. Valid Regulatory Alternatives Do Exist	18
CONCLUSION	20

TABLE OF AUTHORITIES

CASES:	Page
Allis Chalmers Corp. v. *Lueck*, 105 S. Ct. 1904 (1985) .	9
Arkansas Louisiana Gas Co. v. *Hall*, 453 U.S. 571 (1981)	2
Arkansas Electric Cooperative Corp. v. *Arkansas Public Service Commission*, 461 U.S. 375 (1983)	9
Cities Service Gas Co. v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950)	17
Energy Reserves Group, Inc. v. *Kansas Power & Light Co.*, 459 U.S. 400 (1983)	8
Exxon Corp. v. *Eagerton*, 462 U.S. 176 (1983)	7
FPC v. *Louisiana Power & Light Co.*, 406 U.S. 621 (1972)	7, 8
Hillsborough County v. *Automated Medical Laboratories, Inc.*, 105 S. Ct. 2371 (1985)	9
Interstate Natural Gas Co. v. *FPC*, 331 U.S. 682 (1947).	9
Maryland v. *Louisiana*, 451 U.S. 724 (1981)	6
Metropolitan Life Insurance Co. v. *Massachusetts*, 105 S. Ct. 2380 (1985)	9
Missouri v. *Kansas Natural Gas Co.*, 265 U.S. 298 (1924)	9
Mobil Oil Corp. v. *Dubno*, 492 F. Supp. 1004 (D.C. Conn. 1980), *appeal dismissed in part and aff'd in part*, 639 F.2d 919 (2nd Cir.), *cert. denied*, 452 U.S. 967 (1981)	2
Montana v. *Blackfeet Tribe of Indians*, 105 S. Ct. 2399 (1985)	9
Northern Natural Gas Co. v. *State Corporation Commission*, 372 U.S. 84 (1963)	*passim*
Pacific Gas & Electric Co. v. *State Energy Resources Conservation & Development*, 461 U.S. 190 (1985) ..	9

TABLE OF AUTHORITIES continued

Page

Pennzoil v. *FERC*, 645 F.2d 360 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982) 2

Philko Aviation, Inc. v. *Shacket*, 462 U.S. 406 (1983) .. 9

Phillips Petroleum Co. v. *Wisconsin*, 347 U.S. 672 (1954) 3

CONSTITUTION AND STATUTES:

Emergency Petroleum Allocation Act, 15 U.S.C. §§ 751-760(h) 2

Federal Power Act, 16 U.S.C. §§ 791(a)-828(c) 10

Natural Gas Act, 15 U.S.C. § 717-717(w):

Section 1(b), 15 U.S.C. § 717(b) 7

Section 7, 15 U.S.C. § 717(f) 5

Natural Gas Policy Act, 15 U.S.C. §§ 3301-3432:

Section 102, 15 U.S.C. § 3312 15

Section 103, 15 U.S.C. § 3313 15

Section 121, 15 U.S.C. § 3331 ..... 2, 3, 8

Section 503, 15 U.S.C. § 3413 2

Section 601(a), 15 U.S.C. § 3431(a) 3, 5

Section 601(a)(1), 15 U.S.C. § 3431(a)(1) ...1, 2, 3, 4, 5

Section 601(a)(1)(A) or (B), or (D), 15 U.S.C. § 3431(a)(1)(A), or (B), or (D) 3, 5

Section 601(c), 15 U.S.C. § 3431(c) 4

Section 601(c)(2), 15 U.S.C. § 3431(c)(2) 6, 16

Section 602(a), 15 U.S.C. § 3432(a) 9

Rural Electrification Act, 7 U.S.C. §§ 901-950(b) 10

Miss. Code Ann. § 53-1-1 (1972) 14, 19

Miss. Code Ann. § 53-3-9(b) (1972) 14

TABLE OF AUTHORITIES continued

MISCELLANEOUS: Page

18 C.F.R. pt. 272 2

Columbia Gas Transmission Corp., 26 FERC ¶ 61,034, ¶ 61,105-106, *appeal docketed sub. nom., Office of Consumers' Counsel* v. *FERC*, No. 84-1099 (D.C. Cir., March 16, 1984) 6

Dutton, *Marketing Opportunities for Producers*, Natural Gas 7 (June 1985) 15

FERC's Proposed Rulemaking: Accelerating the Spot Market, Natural Gas 18 (Sept. 1985) 15

FPAS NGPA Inf. Serv. § 601:220, pp. 3-4 4

Keagle, *Natural Gas Purchases: The End-user Viewpoint*, Natural Gas 13 (July 1985) 15

Means, *The Viability of Direct Producer Sales*, Natural Gas 6 (April 1985) 15

Note, *The Legislative History of the NGPA: Title I*, 59 Tex. L. Rev. 101 (1980) 2

Pendley, *Blueprint: Partial Deregulation of Natural Gas*, A.B.A. Nat. Resources & Env't, Spr. 1985, at 25 8

Pierce, *Natural Gas Regulation, Deregulation, & Contracts*, 68 Va. L. Rev. 63 (1982) 4, 11, 12

Pierce, *Reconsidering the Roles of Regulation and Competition in the Natural Gas Industry*, 97 Harv. L. Rev. 345 (1983) 4, 12

Statewide Rule 48 of the State Oil & Gas Board of Mississippi ..... *passim*

Transcontinental Gas Pipeline Corporation, 26 FERC ¶ 61,362 (1984) 6

Wilson, *Natural Gas Market: Competition Heats Up*, U.S.A. Today, December 7, 1984, at 4b, col. 1 15

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

APPELLANT'S REPLY BRIEF

I. PREEMPTION

A. The Arguments Against Preemption are Fatally Flawed

Transco's opponents all assume that the *Natural Gas Act* (NGA) jurisdiction of the Federal Energy Regulatory Commission (FERC) over *wellhead sales* is the only federal regulation affected by Mississippi's Rule 48. Therefore, they argue there is no longer federal preemption of Mississippi's selective ratable purchase requirement on high cost gas, since Section 601(a)(1) of the Natural Gas Policy Act (NGPA) has eliminated FERC's NGA jurisdiction over high cost gas wellhead sales. There are at least three reasons why this approach must fail.

1. Partial Wellhead Deregulation under the NGPA has not created a regulatory gap which Congress intended the states to enter.

The NGPA was passed expressly to complement and supplement the NGA. It is an integral part of the federal scheme of regulation over the natural gas industry. This new federal scheme was designed for the same purpose as the NGA: to protect the consumer by assuring adequate supplies of gas at reasonable rates. *See* Note, *The Legislative History of the NGPA: Title I,* 59 Tex. L. Rev. 101, 123-24 (1980). The NGPA contains a carefully designed, phased deregulation of specific wellhead prices as part of a modification and expansion of the existing federal regulatory scheme.[1] It would be inconsistent with the Congressional purpose to permit the states to regulate what Congress has determined should not be regulated.[2] *Arkansas Louisiana Gas Co.* v. *Hall,* 435 U.S. 571, 580 (1981).

As its title suggests, Section 601 of the NGPA is designed to establish a guideline as to which of the two *federal* acts governs FERC's regulation of natural gas sold or transported in interstate commerce and the "natural gas companies" selling or transporting that gas. There is nothing in this provision, the Conference Report, or the legislative

---

[1] One cannot ignore the fact that Congress created this complex new federal scheme rather than just deregulate natural gas. No gas has been "completely" or "totally" deregulated as has been asserted. Even today, before any first sales of gas can be considered both exempt from NGA jurisdiction and price "deregulated" under NGPA § 121 or § 601(a)(1), producers must complete the eligibility determination process required under NGPA § 503. 18 C.F.R. pt. 272; *Pennzoil* v. *FERC,* 645 F.2d 360, 381-82 (5th Cir. 1981). *See also* NGPA §§ 313, 314 and 315 for continuing federal regulation of first sales of so-called "deregulated" gas.

[2] Similarly, the 1975 Amendment to the Emergency Petroleum Allocation Act (EPAA), 15 U.S.C. §§ 751-760(h) represented an affirmative federal decision that certain oil prices be set by the free market, subject only to standby federal controls. This affirmative federal decision was held to preempt any state attempt to directly regulate those decontrolled oil sales. *Mobil Oil Corp.* v. *Dubno,* 492 F. Supp. 1004 (D. Conn. 1980), *appeal dismissed in part and aff'd in part,* 639 F.2d 919 (2nd Cir.), *cert. denied,* 452 U.S. 967 (1981).

history which suggests that Section 601 was intended to change the historic dividing line between federal and state jurisdiction over natural gas in interstate commerce. The fact that Section 601 prevented the FERC's *NGA* jurisdiction from expanding to certain new wellhead sales certainly does not translate into the withdrawal of all *federal* jurisdiction and a regulatory gap into which the states may now intrude.

2. Section 601(a)(1) has not affected interstate pipeline regulation.

The specific issue in this case is whether a state can force an interstate pipeline to purchase gas it otherwise would not purchase or regulate the terms of that purchase. Section 601(a)(1) does nothing to limit the exclusivity of FERC's NGA jurisdiction over interstate pipelines. However, Section 601(a)(1) does affect FERC's NGA jurisdiction over certain producer wellhead sales. The critical phrase is "solely by reason of" found in Section 601(a)(1)(A), (B) and (D).

Under *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), an independent producer was considered to be a "natural gas company" and regulated under the NGA only when it *sold* gas for transportation and resale in interstate commerce. Under the NGPA, when a producer sells high cost gas to an interstate pipeline, that producer is no longer personally subject to NGA jurisdiction because NGA jurisdiction was "solely by reason of" the wellhead sale.[3]

On the other hand, Transco, as an interstate pipeline, purchases gas for transportation and sale in interstate commerce. FERC's NGA jurisdiction over Transco's operations is not "solely by reason of" the first sale and is indeed totally unrelated to the first sale. It is clear that FERC's NGA jurisdiction over Transco is not at all affected

---

[3] Of course the seller (and the natural gas sold by him) cannot be exempt from both NGA and NGPA price jurisdiction unless and until that gas is finally determined to be "deregulated" under both Sections 121 and 601(a) of the NGPA. *See supra* note 2.

by Section 601(a)(1). Under the federal regulatory scheme, the cost of gas and the cost of service of interstate pipelines are reflected in rates charged to the consumer. There is no indication that Congress intended the states to have control over any of these and other functions which directly affect the interstate consumer.[4] This is FERC's exclusive domain.

The legislative history of the NGPA clearly indicates that Congress intended, in certain instances, to relieve *producers* from the NGA utility-type regulations.[5] Congress did not intend to relieve the pipelines from comprehensive federal regulation.[6]

3. A pipeline's purchase cannot be regulated by the state without conflicting with FERC's regulation of interstate transportation and sales.

Coastal and Getty both maintain that the outcome of *Northern Natural Gas Co.* v. *State Corporation Commission*, 372 U.S. 84 (1963), was the result of NGA jurisdiction over wellhead sales and the right of the Federal Power

---

[4] The standard under which FERC regulates an interstate pipeline's purchased gas costs has been modified by Section 601(c) which expressly addresses the intricate relationship between the pipelines' cost structures and the eventual cost of their wholesale customers. However, even Transco's opponents do not claim that Section 601(c) creates any regulatory gap for the states to occupy.

[5] *See* Appellant's Brief (App. Br.) at 12-13; "Curtis/Jackson letter" of September 8, 1978, FPAS NGPA Inf. Serv. § 601:220, pp. 3-4.

[6] In two articles, cited numerous times by the Mississippi Supreme Court and Appellees herein, Professor Pierce concludes that "deregulation" by the NGPA was limited to producers and not the pipelines. *See* Pierce, *Natural Gas Regulation, Deregulation, and Contracts*, 68 Va. L. Rev. 63, 86-90 (1982) (hereinafter Pierce I); Pierce, *Reconsidering the Roles of Regulation and Competition in the Natural Gas Industry*, 97 Harv. L. Rev. 345, 348-50 (1983) (hereinafter Pierce II). Because of the many market distortions created by pipeline regulation and because of significant changes in the pipelines' position in the gas market since 1938, he suggests that the existing *"pervasive regulation of gas pipelines as public utilities should be replaced by a less intrusive form of regulation . . . ."* Pierce II, at 384 (emphasis added).

Commission (FPC), at that time, to set wellhead prices and require certificates of public convenience and necessity from producers before the gas could be sold. However, *Northern Natural* was not premised on whether there was a contract or whether the gas was certificated and it involved no wellhead price issue.[7] Furthermore, this contention is contrary to the express language in the majority opinion. Mr. Justice Brennan made it perfectly clear that the conflict which required pre-emption did not involve wellhead sales. The conflict involved the pipeline's cost structures and the extent to which any regulation thereof by a state would inevitably impact on the FPC's jurisdiction over transportation and sale in interstate commerce. Today the "intricate relationship" between a pipeline's cost structure and its resales rates is even more critical because of the wide disparity among wellhead prices after deregulation, in addition to unprecedented take-or-pay problems.

Getty and Coastal proceed to argue that Section 601(a)(1) of the NGPA has now separated a pipeline's purchase of natural gas from its operation of facilities, transportation, and resale of that gas, all admittedly still regulated by FERC under the NGA. As "proof" of this contention, they assert that certificates of public convenience and abandonment approval under NGA § 7 are no longer required for first sales of gas qualifying under Section 601(a)(1)(A) or (B). However, this begs the question. Just like *Northern Natural,* there is no issue of producer certificates or abandonment in this case.

Mississippi is requiring Transco to purchase high cost gas it otherwise would not purchase on "reasonable terms, including a reasonable price, determined by reference to prevailing market conditions and other economic consid-

---

[7] 372 U.S. at 86-7. In *Northern Natural,* the FPC took the position that the only interference the Kansas order created was the affect of take-or-pay payments on resales costs if the pipeline followed the state order rather than the dictates of its long term gas purchase contracts. 372 U.S. at 96, 99 n.1.

erations."[8] These are direct gas purchase costs which, absent fraud, abuse or other similar grounds, must be passed through to Transco's resales customers.[9] One cannot ignore the conflict that this ratable take order will have with FERC's current ongoing examination of pipelines' purchasing practices to determine whether such practices are in accord with a "fundamental duty to provide service at the lowest reasonable rate consistent with maintenance of adequate service [to customers or consumers]."[10] Clearly, there would be a direct conflict if FERC were to determine that Transco should not purchase the very supplies of non-contract gas that Transco is purchasing in order to comply with Rule 48.[11] FERC Br. at 21-22.

Mississippi's action is no less an intrusion than the Louisiana First Use Tax which was declared preempted by the NGA and NGPA in *Maryland* v. *Louisiana*, 451 U.S. 724 (1981). It interferes more with FERC's jurisdiction than

---

[8] Jurisdictional Statement (J.S.) App. A at 55a. Presumably what is reasonable with reference to the prevailing market conditions and other economic considerations will be determined by the State Oil and Gas Board. The court further stated that the Board's attempt to fix prices at a higher level was not unconstitutional; it merely had not been sanctioned by the Mississippi legislature.

[9] Section 601(c)(2), 15 U.S.C. § 3431(c)(2).

[10] *Columbia Gas Transmission Corp.*, 26 FERC ¶ 61,034, ¶ 61,105-106, *appeal docketed sub. nom., Office of Consumers' Counsel* v. *FERC*, No. 84-1099 (D.C. Cir., March 16, 1984). *See Transcontinental Gas Pipe Line Corp.*, 26 FERC ¶ 61,362 (1984) (setting Transco's purchasing practices for hearing).

[11] This issue is presently before the Commission in Transco's current PGA proceedings. *See* Assoc. Gas Dist. Br. at 13-15. On August 16, 1985, the FERC staff filed a brief which argued:

> Mississippi Rule 48, which requires Transco to take gas ratably from all wells in a common pool, prevents Transco from pursuing a least cost purchasing strategy and results in higher costs to ultimate consumers in violation of sections 4 and 5 of the NGA.
>
> The Commission should exercise its exclusive jurisdiction over Transco's purchasing practices and direct Transco to pursue a least cost purchasing strategy irrespective of Rule 48.

Initial Brief of Commission Staff, *Transcontinental Gas Pipe Line Corp.*, Docket Nos. TA 85-1-29 and TA 85-3-29, at p. 7 (August 16, 1985).

the Alabama severance tax pass-through prohibition this Court preempted with respect to sales made to interstate pipelines. *Exxon* v. *Eagerton*, 462 U.S. 176 (1983).

Another analogous case is *FPC* v. *Louisiana Power and Light Co.*, 406 U.S. 621 (1972) (hereinafter *LP&L*). In *LP&L*, this Court determined whether the FPC, during the national gas shortage, could direct a pipeline to curtail its direct sales to industrial customers. *LP&L* argued, under Section 1(b) of the NGA, that such direct sales to industrial customers were expressly exempted from any FPC jurisdiction. The Court noted:

> In a borderline case where congressional authority is not explicit, we must ask whether state authority can practicably regulate a given area and, if we find that it cannot, then we are impelled to decide that federal authority governs.

406 U.S. at 631. In 1972, 37% of the pipeline's sales were direct sales to industrial customers. The Court concluded that the states would not effectively regulate those direct sales without creating a "seriously inequitable system of gas distribution" nationwide, stating:

> The conflicting results would necessarily produce allocations determined simply by the ability of each [direct sale] customer to pump its desired volume from a pipeline. . . . Besides a state agency empowered to regulate these contracts would be obliged to regulate in the State, not the national interest. . . . The unavoidable conflict between producing States and consuming States will create contradictory regulations that cannot possibly be equitably resolved by the courts. With these problems in mind, the desirability of uniform federal regulation is abundantly clear.

Id. at 633-35. The Court went on to determine that the FPC did have authority to require curtailment of these direct sales through its broad NGA transportation jurisdiction. *Id.* at 636-41.

This case presents practical problems which are analogous to the problems faced in *LP&L*. Instead of facing a gas shortage and curtailment of deliveries, consumers are

today faced with the irony of rising gas costs despite low demand and a surplus of gas. Producers now claim that FERC only has jurisdiction over gas that is still price regulated at the wellhead, with no control over a pipeline's purchase of deregulated gas.[12] Producing states, facing a producer constituency and lower severance tax revenues, will necessarily regulate in the state, not the national interest.[13] If the states are allowed to regulate pipeline purchases of the deregulated gas, the inevitable result will be a kaleidoscopic variation of regulatory schemes, each with its unique impact on the ability of FERC to ensure adequate gas supplies and service at just and reasonable rates in the interstate gas market.[14] The necessity for uniform federal regulation is as abundantly clear in today's market as it was in the gas shortage facing the Court in *LP&L. Id.* at 635-36.

B. The Preemption Cases Dealing With Other Federal Legislation Have No Precedential Value.

Several recent preemption cases dealing with entirely different legislation have been cited for the proposition that, absent express preemption or direct conflict, the Court should not readily infer preemption just because of complex federal legislation.[15] However, the holding of these

---

[12] As of January 1, 1985, additional categories of gas were price deregulated. 15 U.S.C. § 3331. Estimates place the volume of this price deregulated gas at over 50% of the nation's production. Pendley, *Blueprint: Partial Deregulation of Natural Gas,* A.B.A. Nat. Resources and Env't, Spr. 1985 at 25.

[13] The Board's action in this case is a perfect example of a state's predisposition to maximize its own gas sales. The Board's duty and authority is limited to protecting correlative rights among *producers* and promoting production at its maximum efficient rate. It had no duty or inclination to consider the pipeline's market and economic problems or to protect consumers in other states. *See* Joint Appendix (J.A.) at 165, 169, 237-38.

[14] Compare Mississippi regulation with the market demand oriented programs of Texas and Oklahoma. *See,* Getty Br., App. A; Texas Br., p. 9; J.S. App. I.

[15] *See,* Getty Br. at 22-24; Miss. Brief at 6; Coastal Br. at 39-40. Coastal has also cited *Energy Reserves Group Inc.* v. *Kansas Power and Light Co.,* 459 U.S. 400 (1983) as "a NGPA case". However, this case

cases have absolutely no precedential value as to determination of congressional intent behind the NGA and NGPA. Moreover, these cases are not even helpful by analogy because of an important distinction in the historical regulation of the transactions at issue in each of the cases. Critical to all but one of these cases is that both the area and the specific transaction or entity over which federal jurisdiction was asserted had historically been regulated by the states.[16] On the other hand, purchases by an interstate pipeline have historically been beyond the scope of state regulation.[17] Thus, since the transaction at issue in this case is within the historic "federal zone", the presumption is in favor of preemption, absent "clear congressional consent" by Congress.[18]

Section 602(a) of the NGPA is the only manifestation of any intent by Congress to cede to the states any Commerce Clause power. However, Rule 48 does not, in any way, comport with what is allowed by Section 602. App. Br. at 45-46.[19]

Arkansas Electric Cooperative Corp. v. *Arkansas Public Service Commission*, 461 U.S. 375 (1983), relied on by

---

dealt with a state statute which applied only to *intrastate* sales; no preemption issue was involved.

[16] *Hillsborough County* v. *Automated Medical Laboratories, Inc.*, 105 S. Ct. 2371, 2376 (1985) (licensing of blood plasma center); *Metropolitan Life Insurance Co.* v. *Massachusetts*, 105 S. Ct. 2380, 2398-99 (1985) (mandated benefits in health insurance contracts); *Pacific Gas & Electric Co.* v. *State Energy Resources Conservation & Development*, 461 U.S. 190, 194-195 (1985) (generation of electrical power).

However, in other recent cases state laws were preempted despite the fact that the area was traditionally regulated by the states. *See, e.g., Allis Chalmers Corp.* v. *Lueck*, 105 S. Ct. 1904 (1985) (common law tort action for bad faith handling of insurance claim preempted by Labor Management Relations Act.); *Philko Aviation Inc.* v. *Shacket*, 462 U.S. 406 (1983) (Federal Aviation Act preempts state personal property recordation law.).

[17] *See Interstate Natural Gas Co.* v. *FPC*, 331 U.S. 682 (1947); *Missouri* v. *Kansas Gas Co.*, 265 U.S. 298 (1924).

[18] *See Montana* v. *Blackfeet Tribe of Indians*, 105 S. Ct. 2399 (1985).

[19] The Mississippi Supreme Court agrees. *See* J.S. App. A at 51a.

Appellees was a preemption case comparing federal jurisdiction under the Federal Power Act of 1938 and the Rural Electrification Act of 1936 with the Arkansas Public Service Commission's attempt to establish wholesale rates charged by the Arkansas Electric Cooperative Corporation (AECC) to its member-retail distributors who were located within the state of Arkansas. The Court began its preemption analysis by noting:

> If AECC were not a rural power cooperative, the wholesale rates it charges to its members would, under the scheme we described in Part I [The Federal Power Act] supra, be subject exclusively to federal regulation. . . . In 1967, however, the FPC held that it had no jurisdiction under the Federal Power Act to regulate wholesale rates charged by rural power cooperatives under the supervision of the REA. Dairyland Power Cooperative, 37 FPC 12, 67 PUR 3rd 340.

461 U.S. at 381-82. The Court further stated:

> Were the FPC or the courts ever definitively to overrule *Dairyland* and decide that the FPC did have jurisdiction, we would obviously be faced with a very different preemption question.

461 U.S. at 383, n.7.

FERC's active regulation of Transco is sweeping in scope and leaves no room for state intervention.[20]

II. COMMERCE CLAUSE

A. The "Practical Effect" of Rule 48 is to Both Burden and Discriminate Against Interstate Commerce.

The replies of both Getty and Coastal spring from the mistaken assumption that Rule 48 is the only revelant factor to be considered under the Commerce Clause. From that false

---

[20] *See* App. Br. at 14-16. On May 30, 1985, 50 Fed. Reg. 24130 (1985), FERC issued a Notice of Proposed Rulemaking, setting forth what can only be described as radical and sweeping changes to its regulation of interstate pipelines. One aspect of this proposed regulation is a new billing mechanism under which pipelines would be required to allocate purchases of low priced "old" gas for the benefit of their existing sales customers.

premise, they proceed to argue that Rule 48 is not unconstitutional because it does not expressly require either the taking of additional gas or the imposition of take-or-pay obligations. Coastal Br. at 44-46, Getty Br. at 31-32.

However, Transco has never represented to this Court that Rule 48, standing alone, violated the Commerce Clause. Rather, Transco has consistently examined the "practical effect" of Rule 48.[21] The practical effect in this case arises from the confluence of four factors—the excess supply and low demand for gas, long term contracts nationwide which contain take-or-pay provisions based upon a high percentage of deliverability, Mississippi's practice of regulating without regard to market demand, and Rule 48. It is the confluence of these factors, not Rule 48 alone, which increases the consumer price of natural gas and discriminates against other producing states. J.S. at 15-19, App. Br. at 38-46. Transco has thoroughly documented the existence of these factors and correctly portrayed their combined result.

Nevertheless, challenges have been made to the factual support for this practical effect.[22] However, the existence of a gas surplus is so clear cut that the Board Chairman volunteered that it could be stipulated at the hearing before the Board. J.A. at 158. Legal Found. Br. at 9, n.16. Further, Transco proffered evidence that, as early as May of 1982, its resales markets were insufficient to consume all of the gas tendered for delivery under Transco's contracts.[23]

---

[21] J.S. at 15-20, App. Br. at 37-40. As noted therein, this Court examines a state law not in a vacuum but in its necessary operation in the real world. This examination necessarily includes the regulatory environment and the customary business relationships, in this case, the existence of long term contracts with high percentage take-or-pay provisions. *See* Pierce I *supra* n.6, at 77-82 and 92-99. Appellees do not disagree that this "practical effect" must be examined, they simply ignore it in this case.

[22] Coastal Br. at 15 and 44, Getty Br. at 31-32 and 36; National Gov. Ass'n Br. at 19.

[23] J.A. at 163-64. This evidence had to be proffered because it was considered irrelevant by the Board. J.A. at 156.

Coastal criticizes Transco for arguing that Rule 48 is unconstitutional under "present market conditions." Coastal Br. at 45-46. Of course this

Since Transco cannot currently resell all of the gas it has under contract, it cannot make any additional purchases of gas required by Rule 48 without displacing contract gas.[24] The result of not taking this gas under contract is to incur additional take-or-pay claims which will inevitably drive up the price of gas to the consumer.[25] However, the Board refused to even admit evidence of the interstate implications of its acts. J.A. at 164-65 and 169.

As to high percentage take-or-pay contracts, Getty admits that in contracts negotiated from 1970 to 1981 the sellers were generally able to demand and receive high percentage take-or-pay provisions. Getty Br. at 35. An *amicus curiae* has admitted that contracts of this type were "characteristic of the natural gas industry." Nat'l Gov. Ass'n Br. at 5. The commentator cited most by Appellees notes that high percentage take-or-pay provisions were not only commonplace in gas contracts but also were caused primarily by the "interaction of . . . distortional [FERC] regulatory mechanisms." *Pierce II supra* n.6, at 369-370; *see also Pierce I supra* n.6, at 92. Long term contracts with take-or-pay provisions have been a part of the regulatory scheme since its inception. To suggest that contract provisions can be ignored because they are "private contracts" is to suggest that the Court ignore the entire marketplace for natural gas.

---

case is based upon present market conditions; there is no need to enforce ratable take regulations except during a gas glut. During the shortages from the late 1960s through 1981, the market was greater than available production. Therefore, every pipeline was willing to take all gas tendered to it. Only since production has exceeded demand has ratable taking become an issue. Since present market conditions are necessary to provoke enforcement of Rule 48, it is improper for Coastal to suggest that those same conditions be ignored when Rule 48 is challenged.

[24] J.A. at 169. Since the Mississippi courts refused to stay enforcement of Rule 48 pending appeal, these adverse consequences are currently occurring.

[25] J.A. at 164-65. An additional result is to discriminate against other states by increasing Mississippi's market share. J.A. at 170; App. Br. at 38-46.

Getty correctly notes that gas contracts usually contain a provision which allows "make up" of gas for which take-or-pay prepayments have been made. Getty Br. at 30. However, interstate burdens are not thereby obviated. First, even if take-or-pay is ultimately recovered, it results in a current charge to the customer. Second, make up rights in this case are an illusion. The applicable make up period is five years. In order to take advantage of any make up rights, however, Transco's resales markets would have to expand to the point where Transco could not only sell all contractual commitments, but also additional volumes sufficient to make up for past deficiencies. Even Getty concedes that the current market surplus is projected to last until 1990. Getty Br. at 30-31. Under Getty's own forecast, take-or-pay obligations incurred from 1982-85 could not be recouped from producers and will be forever lost.

B. The Interests of Fairness are Not Promoted by Rule 48.

One argument which appears throughout the Respondents' briefs is that Rule 48 is designed to promote "fairness" by giving certain Mississippi oil and gas investors a right to sell gas. Indeed, the Mississippi Supreme Court cites "fairness" as the legitimate local interest which supports Rule 48. J.S. at 34a-35a.

However, attempts to justify Mississippi's regulation as essential to fairness and the prevention of drainage are unsupported by the record. Both Coastal and Getty give the impression that there was ratable production and taking from the six wells in question prior to July 1, 1982, when Transco, due to its inability to market its gas already under contract, first refused to take gas it was not contractually required to take. Coastal Br. at 11; Getty Br. at 6-7. However, a comparison of actual production with the established well allowables for the six wells at issue reveals that two of the wells operated by Getty were producing gas in *excess* of their state allowables [26] and one producing well operated

---

[26] A comparison of production figures for April-June, 1982, J.A. at 10-11, with well allowables for the same period, J.A. at 241-42, reveals that

by Florida Exploration had not even been granted an allowable.[27] The producers' geological and engineering witnesses also admitted that these wells were producing unratably and drainage was occurring *before* Transco made any requests to reduce takes. J.A. at 17-19, 95-96.

Mississippi has the statutory policy of encouraging production at maximum efficient rates of flow. Miss. Code Ann. § 53-1-1 (1972). In 1982, the Board's approach to this goal was no production regulation at all.[28] Therefore, the Rule of Capture flourished in Mississippi, unabated and unrestricted by considerations of "preventing waste" or "fairness."

Further, Mississippi's approach to "fairness" ignores the interests of three very important groups—consumers of natural gas, other producing states and interstate pipelines.

At one end of the pipeline is the ultimate consumer of natural gas. The consumer may be an individual homeowner which must purchase gas for heating purposes or it may be a large industry which has the flexibility to switch to alternate fuels depending on price. To these consumers, "fairness" means adequate supplies of gas at the lowest possible price.

At the other end of the pipeline are producers of natural gas such as Getty and Coastal. Getty is typical of those producers which secured contracts with a pipeline for the sale of natural gas prior to the decline in the market. These contracts bear a very high price and also very high percentage take-or-pay obligations. To Getty, therefore, "fair-

---

the Getty-Rogers well produced 104.6% of its allowable and the Getty-Buckley produced 143.8% of its allowable. Meanwhile, the two other wells with allowables were producing only 55% and 62% of those allowables. *Id.*

[27] *Compare* J.A. at 10-11 *with* J.A. at 241-242. Under Mississippi law the Florida Exploration wells without allowables should not have been producing at all. Miss. Code Ann. § 53-3-9(b) (1972).

[28] It is apparent from the State Oil and Gas Board's "allowable order", Transco General Exhibit B, that the Board was setting allowables for every gas well in the state at whatever the operator reported the well capable of producing, without regard to any other conservation factor.

ness'' is the continuing sale of gas at high prices or the collection of high take-or-pay payments under its contracts in order to maximize the return on its investment.

The other class of producers is represented by Coastal. These producers did not commit their gas in order to secure long term gas purchase contracts with pipelines. To Coastal, therefore, ''fairness'' is to have the state assure it of a ready market for its gas.[29]

Also involved in the ''fairness'' question are other producing states. Mississippi's approach is certainly unfair to those states whose total production is reduced because of this discrimination. *See* J. S. at 21-22, App. Br. at 40-42. This will be particularly distasteful to states like Texas and Oklahoma which limit production to market demand. *See* J.S. App. H and I; Getty Br., App. A.

Caught in the middle of these competing interests are the interstate pipelines. Their ''profit'' is not based upon gas prices because purchased gas costs are, subject to NGPA

---

[29] Of course, Coastal did have other sales opportunities available to it. Coastal's observation that Transco is denying it market access by some monopolistic control over the "wellhead market" in these two gas fields is contradicted by the record. Coastal Br. at 7. Despite the Board's declaration of irrelevance, the record clearly shows that another pipeline was actively competing with Transco in these fields, was building separate facilities, and had a significant amount of the gas not being taken under long-term contracts. J.A. at 128, J.S. App. A. at 15a. It is further undisputed that Transco had offered to buy the gas at market price and subsequently had offered every non-contract owner in these wells access to its facilities for transportation to any other purchaser. J.A. at 66-73.

Furthermore, direct consumer/producer sales on the spot market now account for a significant portion of the total natural gas wellhead sales within the United States. *FERC's Proposed Rulemaking: Accelerating the Spot Market,* Natural Gas 18 (Sept. 1985). *See also,* Dutton, *Marketing Opportunities for Producers,* Natural Gas 7 (June 1985); Means, *The Viability of Direct Producer Sales,* Natural Gas 6 (April 1985); Keagle, *Natural Gas Purchases: The End-user Viewpoint,* Natural Gas 13 (July 1985); Wilson, *Natural Gas Market: Competition Heats Up,* U.S.A. Today, December 7, 1984, at 4b, col. 1. Coastal acknowledges that, as of March 1985, only 9 of the 36 purchasers of natural gas from Mississippi were interstate pipelines. *See,* Coastal Br. at 7, n.7.

Section 601(c)(2), passed through directly to those consumers willing to buy. Transco's return on its investment is governed totally by FERC, which regulates so as to assure just and reasonable rates to the consumer. To Transco, therefore "fairness" lies in being allowed to purchase gas and perform service in accord with the dictates of its market and federal regulation, which are not currently consistent with Rule 48.

It is clear that "fairness" means different things to different people. It is equally clear that Mississippi has not and cannot balance all the relevant interests that deserve "fairness." Mississippi has simply made a choice which favors its producer constituents at the clear expense of the pipelines, other states, and the consumer.

The Mississippi Supreme Court justifies placing the burden on the consumer of natural gas by stating that the NGPA contemplated and approved increases in the consumer price of gas.[30] Certainly the NGPA did try to correct a severe market shortage by increasing financial incentives for the exploration and production of natural gas. The necessary evil attendant with this approach was an increase in the consumer price of natural gas. However, the NGPA goal of adequate supplies of natural gas has been long since realized. Therefore, the other federal goal—gas at reasonable prices—now comes into play. Mississippi's action clearly frustrates this goal; therefore Mississippi cannot justify treating the consumer unfairly by saying it is sanctioned by the NGPA.

Mississippi's approach to "fairness" violates the Commerce Clause as well as the goals of the NGPA. Because

---

[30] J.S. App. A at 35a-36a and 37a-38a. This argument that the NGPA somehow sanctions price increases to the consumer was also adopted by Appellees, Miss. Br. at 15, and Getty Br. at 35-36. Getty even suggests that consumers should be "appreciative" of these higher prices because of the production thereby encouraged. *Id.* at 29 and 35. However, the simple fact is that there is currently an excess of production. No legitimate interest can be served by further excesses. The public is not buying this high priced gas, much less "appreciating" it.

the consumers of natural gas are part of interstate commerce, they are protected from such unfair treatment. However, the production of natural gas is not part of interstate commerce. *Northern Natural,* 372 U.S. at 94. Thus, Mississippi can legally prorate *production* and require its producers with contracts to share their markets with producers without contracts. Getty objects to this approach because proration will reduce its sales and deprive it of the right to seek take-or-pay payments on gas which it is not allowed to produce. However, if the State desires to give all of its producers fair access to a limited market, the only way to constitutionally achieve that desire is to reduce the allowable, and thereby reduce the unbalanced access of those producers in the field with contracts.

C. *Peerless* Does Not Support Rule 48.

Appellees have consistently cited *Cities Service Gas Co.* v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950) (hereinafter *Peerless*), as support for the proposition that all ratable take regulations are approved under the Commerce Clause. However, *Peerless* is cited for its result only; the Appellees have unfortunately ignored its reasoning.

The inapplicability of *Peerless* has been discussed at length elsewhere and need not be repeated herein. J.S. at 22-24; App. Br. at 44-45. Suffice it to say that *Peerless* stands only for the proposition that state actions which result in insignificant price increases can be constitutional.[31] No pre-

---

[31] Getty tries to force this case under *Peerless* by claiming that the price impact of Rule 48 is insignificant because of the small quantities of deregulated gas in 1981. Getty Br. at 30-31. By 1982, however, deregulated gas had reached 7% of the national gas market. Because of the high price differential between this gas and other gas, even this modest amount created a significant impact upon the average cost of gas for each pipeline. J.S. at 24, n.26.

Getty also ignores the fact that wellhead sales of much of § 102 and § 103 gas were price deregulated as of January 1, 1985. 15 U.S.C. § 3331 (a). Thus the category of gas to which the Mississippi Supreme Court's decision applies, J.S. at 29a, has grown from 7% to 50% of the total market. "Deregulated" gas constitutes a constitutionally significant portion of today's gas market.

emption issue was raised nor did the Court consider the significant price increases and discrimination involved in this case.[32]

D. Valid Regulatory Alternatives Do Exist.

In previous briefs, Transco has outlined a less burdensome regulatory alternative which is both effective and clearly constitutional—market proration. J. S. at 20-21, App. Br. at 46-48.

Getty now claims that proration will not work because it does not give a market to noncontract producers. However, the limitation of each producer to his pro rata share of market demand is only the first step. The second step is for the state or the well operator to allocate the production allowed by the available market to all producers on an equitable basis.[33] Tc the extent that a producer is legally precluded from producing gas, it should not be able to seek to enforce take or take-or-pay obligations in excess of those limits. Once these obligations in excess of market demand are eliminated, and the production is prorated among all producers, then no adverse impact will result to the interstate consumer. *See Northern Natural,* 372 U.S. at 98-99 (Harlan, J. dissenting). Likewise, this system avoids interstate discrimination because it recognizes that the total market is limited and restricts the state's production to its fair share of that market. In *Northern Natural,* this Court approved the alternative as an effective and constitutional

---

[32] Further, since the pipeline, unlike Transco, was also the major producer, 340 U.S. at 180, *Peerless* involved the state's unquestioned authority to regulate production. *Id.* at 186.

[33] Getty argues that would not be effective because the pipelines control the flow rate of the wells. Getty Br. at 36-37. Again, one can look to the record in this case for contradiction. Here, Transco was taking the gas in question from a facility built and operated by Getty. It was Getty, the well operator, that produced each well and determined how producers in each well were to be paid for that gas. J.A. at 115 and 131-32.

means of achieving the state's purposes of protecting correlative rights.[34] *Id.* at 94, n.12.

On the other hand, Coastal objects to market proration on the ground that first, it is prohibited by Mississippi law and second, it may result in greater burdens than Rule 48. Coastal Br. at 46-49. It is true that the Board believes a Mississippi statute prohibits it from considering market demand and setting well allowables.[35] *See* Miss. Code Ann. § 53-1-1 (1972) and J.A. 93-95. However, it makes no differance whether the offending enactment is a Board regulation or a Mississippi statute. In either event, burdensome laws must fall before the Commerce Clause. If Mississippi desires to grant a market to producers like Coastal, it can change its statutory scheme as necessary to allow the Board to regulate in a constitutional manner.

Coastal's second objection is based upon the dissent of Justice Harlan in *Northern Natural.* However, nowhere does the dissent suggest that a market proration system during an oversupply of gas will result in greater costs. Indeed, Justice Harlan observes that if take-or-pay obligations are relieved, then the net effect may be an actual decrease in the price of gas. 372 U.S. at 98, 105.

Transco does agree that a proration system will place greater administrative burdens on the Board. *Id.* at 100-101. However, the majority in *Northern Natural* felt that these burdens should be borne by state regulatory agencies, not

---

[34] With respect to the so called drainage phenomenon referred to by the Mississippi Supreme Court and Appellees, the drainage of reserves from one well to another can be remedied effectively by the state setting lower production allowables for wells causing drainage until correlative rights in the common reservoir are balanced. Similarly, the suggested practice of requiring a well operator to share the market by allocating production among all co-owners would remedy any production imbalances between contract and non-contract producers in a common well.

[35] However, that statute further provides that the limitation is "subject to the prevention of waste." *Id.* Indeed, for many years prior to 1978, Mississippi established gas allowables on the basis of market demand nominations by pipelines. *See* Appendices C and D to Appellant's Rebuttal Brief before the Mississippi Supreme Court.

shifted to the shoulders of the interstate pipeline companies. *Id.* at 92.

Mississippi states that the legitimate local interest supporting Rule 48 is "fairness." However, that particular interest can be adequately served by producer regulations which do not burden the interstate market. Mississippi's regulation in this case intrudes into interstate commerce further than is necessary to achieve its stated objective, serves no legitimate interest, is "unfair" and is therefore unconstitutional.

CONCLUSION

The decision of the Mississippi Supreme Court should be reversed.

Respectfully submitted,

JOHN MARSHALL GROWER
(Counsel of Record)
JEFFERSON D. STEWART
R. WILSON MONTJOY II
BRUNINI, GRANTHAM, GROWER & HEWES

R. V. LOFTIN, JR.
THOMAS E. SKAINS
DAVID A. GLENN
TRANSCONTINENTAL GAS PIPE LINE CORPORATION

Attorneys for Appellant

Office-Supreme Court, U.S.
FILED
MAY 29 1985
ALEXANDER L. STEVAS,
CLERK

(8)

No. 84-1076

In the Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
APPELLANT

v.

STATE OIL AND GAS BOARD OF MISSISSIPPI AND
COASTAL EXPLORATION, INC., ET AL.

ON APPEAL FROM THE SUPREME COURT OF MISSISSIPPI

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE SUPPORTING REVERSAL

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

WILLIAM H. SATTERFIELD
General Counsel

JEROME M. FEIT
Solicitor

JOSEPH S. DAVIES
LESLIE J. LAWNER
JOHN H. CONWAY
Attorneys
Federal Energy Regulatory Commission
Washington, D.C. 20426

38 pp

QUESTION PRESENTED

Whether the ruling of the Mississippi Supreme Court that an interstate pipeline is required to purchase gas at a uniform percentage (*i.e.*, ratably) from all owners in a common pool of gas, even when the inevitable consequence of the state regulation will be to increase rates charged ultimate consumers of gas in other states, constitutes state regulation forbidden under the Supremacy and Commerce Clauses of the United States Constitution.

TABLE OF CONTENTS

Page

Interest of the United States and the Federal Energy Regulatory Commission 1

Statement 2

A. The statutory and regulatory background 3

B. The relevant facts of this case 5

C. The decisions of the state courts 6

Summary of argument 7

Argument:

I. The state ratable-take rule at issue here is invalid because it is inconsistent with the comprehensive federal scheme of regulation of interstate transactions involving natural gas 10

A. The presently operative federal scheme of natural gas regulation occupies the entire field of wellhead transactions and thus renders the state order invalid 11

B. The state's regulation of Transco's purchasing practices directly conflicts with the Commission's regulatory responsibilities under the NGPA and the Natural Gas Act 17

II. The Board's order impermissibly interferes with interstate commerce 26

Conclusion 29

TABLE OF AUTHORITIES

Cases:

American Paper Institute, Inc. v. *American Electric Power Service Corp.*, 461 U.S. 402 11

Arkansas Electric Cooperative Corp. v. *Arkansas Public Service Commission*, 461 U.S. 375....14, 16, 26, 28

Cases—Continued: Page

Arkansas Louisiana Gas Co. v. *Hall*, 453 U.S. 571 26
Atlantic Refining Co. v. *Public Service Commission*, 360 U.S. 378 2
Cities Service Gas Co. v. *Peerless Oil & Gas Co.*, 340 U.S. 179 .... 7, 9, 10, 28, 29
City of Philadelphia v. *New Jersey*, 437 U.S. 617 27
Clark v. *Uebersee Finanz-Korporation, A.G.*, 322 U.S. 480 11
Columbia Gas Development Corp. v. *FERC*, 651 F.2d 1146 26
Columbia Gas Transmission Corporation, 26 F.E.R.C. ¶¶ 61,034 and 61,334, appeal pending *sub nom. Office of the Consumers' Counsel* v. *FERC*, No. 84-1099 (D.C. Cir. filed Mar. 16, 1984) 21, 22
Consumer Energy Council of America v. *FERC*, 673 F.2d 425 23
Energy Reserves Group, Inc. v. *Kansas Power & Light Co.*, 459 U.S. 400 17
Exxon Corp. v. *Eagerton*, 462 U.S. 176 .... 3, 17, 26
FERC Order No. 49, 8 F.E.R.C. ¶ 61,333 23
FPC v. *Corporation Commission*, 362 F. Supp. 522, aff'd, 415 U.S. 961 29
Fidelity Federal Savings & Loan Ass'n v. *De La Cuesta*, 458 U.S. 141 16
Hill v. *Florida*, 325 U.S. 538 22
Lodge 76, International Associaiton of Machinists v. *Wisconsin Employment Relations Commission*, 427 U.S. 132 .... 13, 22
Maryland v. *Louisiana*, 451 U.S. 725 27
Northern Natural Gas Co. v. *State Corporation Commission*, 372 U.S. 84 .... *passim*
Pennsylvania v. *West Virginia*, 262 U.S. 553 26
Phillips Petroleum Co. v. *Wisconsin*, 347 U.S. 672 .... 12, 25
Pike v. *Bruce Church, Inc.*, 397 U.S. 137 .... 27, 28
Public Service Commission v. *Mid-Louisiana Gas Co.*, 463 U.S. 319 .... 3, 12, 16, 20, 21, 22, 26
Rice v. *Santa Fe Elevator Corp.*, 331 U.S. 218 16
Transcontinental Gas Pipeline Corp.:
23 F.E.R.C. ¶ 61,292 21
26 F.E.R.C. ¶ 61,361 21

Constitution, statutes and regulation: Page

U.S. Const. Art. I, § 8, Cl. 3 (Commerce Clause) 3, 7, 17, 26, 27, 28
Natural Gas Act, 15 U.S.C. 717 *et seq.* 1, 2-3
§ 2(6), 15 U.S.C. 717a(6) 25
§ 4, 15 U.S.C. 717c 2, 4, 7
§ 5, 15 U.S.C. 717d 2, 4, 7
§ 7, 15 U.S.C. 717f 12
§§ 20-22, 15 U.S.C. 717s-717u 2
Natural Gas Policy Act of 1978, 15 U.S.C. 3301 *et seq.* 1-2, 3
Tit. I, 15 U.S.C. 3311 *et seq.* 2
§ 102, 15 U.S.C. 3312 4
§ 102(c), 15 U.S.C. 3312(c) 3-4
§ 103, 15 U.S.C. 3313 4
§ 103(c), 15 U.S.C. 3313(c) 3-4
§ 104, 15 U.S.C. 3314 4
§ 105, 15 U.S.C. 3315 3-4
§ 106, 15 U.S.C. 3316 4
§ 106(b), 15 U.S.C. 3316(b) 4
§ 107, 15 U.S.C. 3317 ..... 4, 5, 13, 14, 25
§ 107(c)(1), 15 U.S.C. 3317(c)(1) 3
§ 108, 15 U.S.C. 3318 4
§ 109, 15 U.S.C. 3319 4
§ 121, 15 U.S.C. 3331 13
§ 121(a), 15 U.S.C. 3331(a) 4
§ 121(b), 15 U.S.C. 3331(b) 3, 23
Tit. II, 15 U.S.C. 3341 *et seq.* 5
Tit. V, 15 U.S.C. 3411 *et seq.*:
§ 501(a), 15 U.S.C. 3411(a) 2
§ 503, 15 U.S.C. 3413 16
§ 504, 15 U.S.C. 3414 2
§ 504(b)(1), 15 U.S.C. 3414(a) 2
§ 505, 15 U.S.C. 3415 16
Tit. VI, 15 U.S.C. 3431 *et seq.*:
§ 601, 15 U.S.C. 3431 ..... 4, 8
§ 601(a), 15 U.S.C. 3431(a) 24, 25
§ 601(a)(1)(A)-(C), 15 U.S.C. 3431(a)(1)(A)-(C) 25

Constitution, statutes and regulation—Continued: Page

§ 601(a)(1)(B), 15 U.S.C. 3431(a)(1)(B) 24
§ 601(a)(1)(D), 15 U.S.C. 3431(a)(1)(D) 25
§ 601(b)(1)(E), 15 U.S.C. 3431(b)(1)(E) 22
§ 601(c), 15 U.S.C. 3431(c) 4, 19, 20, 23
§ 601(c)(2), 15 U.S.C. 3431(c)(2) 2, 5, 8, 21, 22
§ 601(c)(2)(B), 15 U.S.C. 3431(c)(2)(B) 5, 22
§ 602(a), 15 U.S.C. 3432(a) 17

Department of Energy Organization Act, § 402(a)(1)(C), 42 U.S.C. 7172(a)(1)(C) 2
42 U.S.C. 7172(a) 1
42 U.S.C. 7295 1
Miss. Code Ann. § 53-1-1 (1972) 6
18 C.F.R.:
Pt. 282 23
Section 282.208 24

Miscellaneous:

1 Energy Information Administration, *Natural Gas Annual 1983* 28
H.R. 8444, 95th Cong., 1st Sess. (1977) 13, 25
H.R. Rep. 95-496, 95th Cong., 1st Sess. Pt. 4 (1977) 13, 25
H.R. Conf. Rep. 95-1752, 95th Cong., 2d Sess. (1978) 17, 23, 25
Haase, *The Federal Role in Implementing the Natural Gas Policy Act of 1978*, 16 Houston L. Rev. 1067 (1979) 23
Note, *Legislative History of the Natural Gas Policy Act: Title I*, 59 Tex. L. Rev. 101 (1980) 4
Note, *Natural Gas Regulation and Vested Property Interests: Ratable Taking, Proration Standards and Fieldwide Civil Liability*, 62 Tex. L. Rev. 691 (1983) 15-16

Miscellaneous—Continued: Page

123 Cong. Rec. (1977):

pp. 2141-2142 25
pp. 19964-19965 25

124 Cong. Rec. (1978):

p. 28633 13
p. 38361 24
p. 38366 16

Ringleb, *Natural Gas Producer Price Regulation Under the NGPA: Regulatory Failure, Alternatives, and Reform*, 20 Houston L. Rev. 709 (1983) 4

S. 2104, 95th Cong., 1st Sess. (1977) 13
S. Rep. 95-436, 95th Cong., 1st Sess. (1977) 12-13, 25

In the Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION, APPELLANT

v.

STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., ET AL.

ON APPEAL FROM THE SUPREME COURT OF MISSISSIPPI

BRIEF FOR THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AS AMICI CURIAE SUPPORTING REVERSAL

INTEREST OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION

Congress has charged the Commission [1] with the responsibility for administering and enforcing the Natural Gas Act, 15 U.S.C. 117 *et seq.*, and the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et*

[1] The term "Commission" herein refers to the Federal Power Commission prior to October 1, 1977, and to the Federal Energy Regulatory Commission thereafter. See 42 U.S.C. 7172(a), 7295.

seq. See Section 402(a)(1)(C) of the Department of Energy Organization Act, 42 U.S.C. 7172(a)(1)(C); Sections 20-22 of the Natural Gas Act, 15 U.S.C. 717s-717u; and Sections 501(a), 504(b)(1) of the NGPA, 15 U.S.C. 3411(a), 3414(b)(1).

Under the Natural Gas Act, the Commission is responsible for establishing the resale rates for natural gas in interstate commerce at "just and reasonable" levels. Sections 4, 5 of the Natural Gas Act, 15 U.S.C. 717c, 717d. Under the NGPA, the Commission is responsible, inter alia, for enforcing the prices for wellhead sales of natural gas established by Congress under Title I of the NGPA, 15 U.S.C. 3311 *et seq.* See Section 504 of the NGPA, 15 U.S.C. 3414. It is also authorized to assure that the passthrough of gas costs by interstate pipelines to their customers is in accord with those prices and is not excessive due to "fraud, abuse, or similar grounds." Section 601(c)(2) of the NGPA, 15 U.S.C. 3431(c)(2). In all cases, the Commission must assure that the public has an adequate supply of natural gas in the interstate market "at the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest." *Atlantic Refining Co.* v. *Public Service Commission*, 360 U.S. 378, 388 (1959).

The Mississippi ratable-take rule at issue here significantly interferes with this comprehensive federal scheme of regulation; unless overturned, the rule is likely to raise the price of gas in the interstate market.

STATEMENT

Appellant, Transcontinental Gas Pipeline Corporation (Transco), is an interstate pipeline engaged in the purchase, transmission, and sale for resale of natural gas in interstate commerce, subject to the Nat-

ural Gas Act, 15 U.S.C. 717 *et seq.*, and the NGPA, 15 U.S.C. 3301 *et seq.* In this case Transco challenges, on preemption and Commerce Clause grounds, the order of the Mississippi courts, requiring Transco to purchase gas "ratably" from all interest owners in a common pool of gas—*i.e.*, to purchase from each interest owner the same percentage of allowable production from the pool as it purchases from every other interest owner.

A. The Statutory And Regulatory Background

The Natural Gas Act, 15 U.S.C. 717 *et seq.*, was adopted in 1938 "to occupy the field of wholesale sales of natural gas in interstate commerce," an area which this Court had held the states were barred from regulating under the Commerce Clause. *Exxon Corp.* v. *Eagerton*, 462 U.S. 176, 184 (1983).

The NGPA extended the scope of Congress's exercise of its authority over the sale of natural gas by adopting, in Title I, a "comprehensive" and "exhaustive" structure of tiered prices for all sales at the wellhead (*i.e.*, "first sales"), whether made in interstate or intrastate commerce. *Public Service Commission* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 332 (1983). Insofar as relevant here, Congress in Title I deregulated the price of certain categories of gas [2] and assigned other categories specified "incentive"

---

[2] The gas at issue here is deregulated "high-cost" gas. Section 107(c)(1) of the NGPA, 15 U.S.C. 3317(c)(1), defines "high-cost natural gas" as gas produced from wells begun on or after February 19, 1977, at completion locations deeper than 15,000 feet. Under Section 121(b) of the NGPA, 15 U.S.C. 3331(b), the "first sale" (*i.e.*, field or wellhead) price of such gas is not subject to price controls. Other gas, qualifying under NGPA Sections 102(c), 103(c), 105 and

ceiling prices in order to stimulate production.[3] At the same time, Title I extended Natural Gas price controls (with an inflation adjustment factor) to particular categories of gas, especially old dedicated gas.[4] The overall objective was "to encourage natural gas production while providing consumers with a smooth transition to natural gas decontrol." [5]

Section 601 of the NGPA, 15 U.S.C. 3431, entitled "Coordination with the Natural Gas Act," links the pricing structure of the NGPA with the provisions of the Natural Gas Act. In Section 601(c), 15 U.S.C. 3431(c), Congress vested the Commission with the authority to ensure that a pipeline's purchased gas costs meet at least two conditions before the Commission allows them to be passed on to the pipeline's customers as "just and reasonable" under Sections 4

106(b), 15 U.S.C. 3312(c), 3313(c), 3315 and 3316(b), was deregulated on January 1, 1985. See Section 121(a), 15 U.S.C. 3331(a).

[3] Incentive categories are: new natural gas and certain Outer Continental Shelf gas (Section 102, 15 U.S.C. 3312); gas from new, onshore production wells (Section 103, 15 U.S.C. 3313); high-cost natural gas (Section 107, 15 U.S.C. 3317); and stripper-well natural gas (Section 108, 15 U.S.C. 3318).

[4] See NGPA Section 104, 15 U.S.C. 3314 (natural gas dedicated to interstate commerce); Section 106, 15 U.S.C. 3316 (gas sold under rollover contracts); and Section 109, 15 U.S.C. 3319 (gas not qualifying for another maximum lawful price).

[5] Ringleb, *Natural Gas Producer Price Regulation Under the NGPA: Regulatory Failure, Alternatives, and Reform*, 20 Houston L. Rev. 709, 711-712 (1983) (footnote omitted). See also Note, *Legislative History of the Natural Gas Policy Act: Title I*, 59 Tex. L. Rev. 101, 116-124 (1980).

and 5 of the Natural Gas Act: (1) that the price was not "excessive due to fraud, abuse, or similar grounds" (Section 601(c)(2), 15 U.S.C. 3431(c)(2)); and (2) that the price was consistent with the Commission's rules regarding incremental pricing under Title II of the NGPA, 15 U.S.C. 3341 *et seq.* (Section 601(c)(2)(B), 15 U.S.C. 3431(c)(2)(B)).

B. The Relevant Facts Of This Case

Beginning in 1978, Transco entered into approximately 35 long-term contracts, some of which contained take-or-pay provisions,[6] to purchase deregulated high cost (Section 107) natural gas from interest-owners in a common pool (the Harper Sand gas pool) in Mississippi (J.S. 2-4; J.S. App. 8a-9a). Until the summer of 1982, Transco purchased all the gas tendered to it from the pool by the various interest owners, regardless of whether it had a contract with the selling interest-owner or not. In the spring of 1982, however, Transco began to experience problems selling its gas to its interstate system-supply customers (J.S. 6; J.S. App. 10a-12a). As a result, in May 1982 Transco announced it would no longer take or purchase gas from the interest owners and producers with whom it did not have contracts (J.S. App. 11a).

Coastal Exploration, Inc., and other non-contract working interest owners, thereupon petitioned the

---

[6] A "take-or-pay" provision in a gas contract requires the purchaser to pay for a specified volume of gas that the producer-seller has available for delivery, regardless of whether the purchaser takes the gas or not. Under such a clause the purchaser usually has the right to take in succeeding years the gas paid for but undelivered.

Mississippi State Oil and Gas Board to enforce its Rule 48, a ratable-take rule (J.S. 6-7),[7] by requiring Transco to purchase from each interest-owner in the pool—including those with whom Transco had no contracts—the same percentage of the pool's allowable production as it purchased from every other interest owner. Transco urged the Board instead to reduce the "allowables" (*i.e.*, the maximum permissible production[8]) for the pool to reflect market demand, or, alternatively, to allocate ratably to all producers the volumes Transco was obliged by contract to purchase from certain of the interest owners. The Board rejected these alternatives. Instead, it required Transco to purchase the reservoir's full allowables ratably from all interest-owners (J.S. App. 104a-113a). The Board also required Transco to purchase all such gas —even the gas that it had not contracted to purchase —under non-discriminatory price and take-or-pay conditions (J.S. App. 112a).

C. The Decisions Of The State Courts

The Mississippi State Circuit Court of the First Judicial District of Hinds County affirmed the Board's order (J.S. App. 59a-103a). It found that the order did not violate this Court's decision in *Northern Nat-*

---

[7] That rule provides:

> Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, or producers shall purchase without discrimination in favor of one owner, operator, or producer against another in the same common source of supply.

[8] In Mississippi, the "allowables" for gas reservoirs are established at the maximum amount of gas a reservoir is capable of producing. See Miss. Code Ann. § 53-1-1 (1972) (reproduced at J.S. App. 128a-129a).

ural Gas Co. v. *State Corporation Commission*, 372 U.S. 84 (1963),[9] or invade the Commission's regulatory authority. In the state court's view, the NGPA had eliminated Commission jurisdiction over wellhead sales of Section 107 gas and other deregulated gas, thereby creating a lacuna the state could fill (J.S. App. 73a-77a).

On further review, the Mississippi Supreme Court reversed the Board's order to the extent that it proscribed differences in wellhead prices, because, in its view, the Mississippi legislature had not authorized the Board to set prices for gas at the wellhead (J.S. App. 48a-55a). However, the Mississippi Supreme Court upheld the Board's order in all other respects. It agreed with the circuit court's view of the effect of the NGPA on *Northern Natural* (J.S. App. 22a-29a). Nor did the court believe that the Board's order violated the Commerce Clause of the United States Constitution. Citing *Cities Service Gas Co.* v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950), the court held that increased prices to consumers in other states do not necessarily render a state's regulation unconstitutional.

SUMMARY OF ARGUMENT

1. More than 20 years ago in *Northern Natural Gas Co.* v. *State Corporation Commission*, *supra*, this Court set aside state ratable-take orders similar to the order at issue here on the ground that they affected the ability of the Commission "to regulate comprehensively and effectively the transportation

---

[9] In *Northern Natural* this Court held that ratable-take orders of the State of Kansas, like the kind involved in this case, were preempted by the Natural Gas Act. See discussion pp. 17-19, *infra*.

and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act." 372 U.S. at 91-92. In this case, the Mississippi courts refused to follow *Northern Natural* on the ground that the NGPA had overturned that decision. Passage of the NGPA, which operates as an overlay upon the provisions of the Natural Gas Act, was not meant to achieve such a result; it simply does not permit the states to assert regulatory authority over wellhead sales in interstate commerce.

The NGPA makes clear that Congress, in removing certain wellhead sales from the Commission's regulatory jurisdiction, intended that they be *de*regulated; it did not intend to permit state regulation sufficient to justify the state Board's ruling here. The state Board's order thus interferes impermissibly with the NGPA, its relationship to the Natural Gas Act, and the nice balance struck in those Acts between regulated and deregulated prices of natural gas.

Additionally, the State, through the Board's order, directly interferes with specific responsibilities delegated by Congress to the Commission under the NGPA/Natural Gas Act scheme. In Section 601 of the NGPA, Congress specifically provided for the Commission's regulation of the passthrough of pipelines' costs of gas purchases to their interstate customers. To this end the Commission is authorized to permit a pipeline to pass through wellhead gas purchase costs if the costs are not "excessive due to fraud, abuse, or similar grounds" (15 U.S.C. 3431(c)(2)) (whether or not they are deregulated prices) and are at levels consistent with the incremental pricing system established under Title II of the NGPA. The Board's order collides with the Commission's duty

under each of these two discrete provisions. The state Board's order interferes with the Commission's responsibility to ensure that Transco's gas purchase costs do not violate the "fraud, abuse, or similar grounds" standard, since the state action will ensure higher rates to interstate customers without any offsetting benefit to them. In addition, the Board's order collides with the aim of the incremental pricing system: to compel pipelines to bid responsibly for deregulated supplies of gas.

In sum, the state Board's order is fundamentally at odds with the federal scheme requiring the Commission to coordinate the NGPA and Natural Gas Act to foster a market in which natural gas can be produced in sufficient quantities at the lowest cost.

2. In any event, the Board's order impermissibly burdens interstate commerce. Through this order, the State has guaranteed a larger share of the interstate market to high-cost Mississippi gas than might otherwise have been secured, and it has done so at the expense of out-of-state customers. This result cannot be justified by the assertion that the State's action is a legitimate conservation measure. The order itself requires gas depletion, and the State has alternative and less intrusive means of checking waste or discriminatory taking through rules aimed not at purchasers but at producers.

This Court's decision in *Cities Service Gas Co.* v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950), does not support the ruling of the courts below, because that decision turned on the minimal impact that the very low wellhead prices of gas then prevailing would have on the price of the gas delivered to consumers (340 U.S. at 187). Current wellhead prices are a great deal higher; they constitute more than half of the price paid by today's gas consumers. Accordingly,

the facts upon which *Cities Service Gas Co.* was based have changed so significantly that its rationale would not today support the result reached in 1950.

ARGUMENT

I. THE STATE RATABLE-TAKE RULE AT ISSUE HERE IS INVALID BECAUSE IT IS INCONSISTENT WITH THE COMPREHENSIVE FEDERAL SCHEME OF REGULATION OF INTERSTATE TRANSACTIONS INVOLVING NATURAL GAS

Both state courts below recognized that if there were no NGPA, the Natural Gas Act, as construed by this Court in *Northern Natural*, would stand as clear authority invalidating Rule 48 of the State Oil and Gas Board.[10] The state courts sought, however, to avoid the reach of *Northern Natural* on the ground that in the NGPA "Congress has declared that the first sale of deregulated gas is never made subject to the Natural Gas Act or to FERC's jurisdiction under the act" (J.S. App. 25a). We submit that the courts'

---

[10] The Mississippi Supreme Court unequivocally stated (J.S. App. 22a):

> All parties agree that prior to 1978 there existed in the Federal Energy Regulatory Commission (formerly the Federal Power Commission) plenary authority to regulate the sale and transportation of natural gas in interstate commerce. No one questions that prior to 1978 this federal authority within its sphere was more than sufficient to preempt any otherwise lawful state authority. *Northern Natural Gas Co.* v. *State Corporation Commission of Kansas*, 372 U.S. 84, 89-90, 83 S.Ct. 646, 649, 9 L.Ed.2d 601, 606 (1963). Prior to 1978 this state was without authority to enforce Rule 48 requiring ratable taking, and any order such as Order No. 409-82 would have been wholly *ultra vires*.

See also J.S. App. 24a-25a.

view wholly misperceives both the scope and coverage of the NGPA and the present viability of *Northern Natural*. We first demonstrate that Congress did not, when it enacted the NGPA, intend the anomalous result of allowing the state to regulate wellhead transactions that were removed from Commission jurisdiction. We show next that *Northern Natural* has not been rendered obsolete by the enactment of the NGPA and that its teaching bars the state action challenged here.

A. The Presently Operative Federal Scheme Of Natural Gas Regulation Occupies The Entire Field Of Wellhead Transactions And Thus Renders The State Order Invalid

Appellee argues that Congress, when it enacted the NGPA, meant to grant to the states expansive power over wellhead transactions at the same time as it signficantly narrowed Commission regulatory authority over such sales. But this argument attributes to Congress the self-defeating intent " 'to paralyze with one hand what it sought to promote with the other.' " *American Paper Institute, Inc.* v. *American Electric Power Service Corp.*, 461 U.S. 402, 421 (1983) (quoting *Clark* v. *Uebersee Finanz-Korporation, A.G.*, 332 U.S. 480, 489 (1947)).

1. In enacting the NGPA, Congress enlarged the focus of federal regulation under the Natural Gas Act by establishing a comprehensive and uniform national scheme of prices for gas at the wellhead applicable to intrastate as well as interstate sales, thereby ending distortions created by separate state and national regulation.

Under the Natural Gas Act, the Commission, until 1954, had exercised regulatory authority only over

the rates and activities of interstate pipelines, not independent producers. Following this Court's decision in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), however, the Commission also began to regulate producer (wellhead) sales to interstate pipelines. Producers, like interstate pipelines, were thereafter required to obtain certificates of public convenience and necessity from the Commission to enter into interstate transactions under Section 7 of the Natural Gas Act, 15 U.S.C. 717f, and the Commission was statutorily obligated to insure that such sales were at "just and reasonable" rates under Sections 4 and 5 of the Act, 15 U.S.C. 717c and 717d. As this Court recently noted, in the wake of *Phillips* the problems of regulating the natural gas industry grew steadily, and "it became apparent that the regulatory structure was not working." *Public Service Commission* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 330 (1983).

A rapidly increasing demand for natural gas exacerbated the problems inherent in implementing *Phillips*. What emerged was a sharp division between the regulated interstate market and the intrastate markets, which were not subject to Commission regulation under the Natural Gas Act. In the early 1970's, this artificial division solidified, and the nation's gas situation worsened as the prices for gas in the intrastate markets grew substantially higher than prices in the interstate market. This price disparity adversely affected the dedication of gas to the interstate market, resulting in serious shortages of gas available for interstate sale. The NGPA was enacted in large measure to eliminate these problems and to provide for increasing reliance on market forces to control sales of gas at the wellhead. S. Rep. 95-436,

95th Cong., 1st Sess. 7-9, 18-25 (1977); H.R. Rep. 95-496, 95th Cong., 1st Sess. Pt. 4, at 101 (1977); H.R. 8444, 95th Cong., 1st Sess. § 401 (1977) (Findings and Statement of Purposes); S. 2104, 95th Cong., 1st Sess. § 2 (1977) (Findings and Purposes).

To this end, in Title I of the NGPA Congress removed price controls altogether from certain categories of gas, including Section 107 gas, to stimulate supplies at the limit of economic recovery. As Senator Jackson explained in presenting the conference report on the NGPA (124 Cong. Rec. 28633 (1978) (emphasis added)):

> Our objective was to target the revenues a producer can expect to receive from production from a given well. *We wanted to elicit the maximum supply response at a minimum cost to consumers.* For example, the most expensive kinds of wells to drill, those over 15,000 feet in depth, are deregulated * * * [because] * * * they deserve the maximum economic incentive.

Since Congress explicitly exercised its power in Section 121 of the NGPA, 15 U.S.C. 3331,[11] to subject certain wellhead sales to the free play of economic forces, its decision is entitled to preemptive force as against state efforts to regulate the area.

As this Court explained in *Lodge 76, International Association of Machinists* v. *Wisconsin Employment Relations Commission*, 427 U.S. 132, 150-151 (1976) (citations and footnote omitted; brackets in original):

---

[11] Section 121, entitled "Elimination of price controls for certain natural gas sales" essentially removed, in three stages, the maximum lawful prices applicable to certain categories of natural gas.

> To sanction state regulation of such economic pressure deemed by the federal Act "desirabl[y] . . . left for the free play of contending economic forces, . . . is not merely [to fill] a gap [by] outlaw[ing] what federal law fails to outlaw; it is denying one party to an economic contest a weapon that Congress meant him to have available." Accordingly, such regulation by the State is impermissible because it " 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.' "

See also *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, 461 U.S. 375, 383-385 (1983).

2. The state order involved here significantly frustrates the free market policies embodied in the NGPA. It would not only require Transco to purchase high-cost Section 107 gas when cheaper gas might be available, but it also would hamper the operation of free market forces by giving the states leverage to control first sales of natural gas.

While the Mississippi Supreme Court declared that the Board's order was invalid to the extent that it explicitly established a price for the gas, this does not eliminate the basic flaw of the order. On the contrary, because of the take-or-pay contract provisions, Transco is faced with a Hobson's choice: its first option is to increase its purchases of high-cost gas from all wells in the common pool to the highest level at which it is contractually required to purchase from any single interest-owner, and make corresponding reductions elsewhere, thereby burdening its interstate customers with high-cost gas when there is already a glut of high priced gas in its interstate market. Transco's other option is no more attrac-

tive: it can reduce the volume of its purchases from the interest-owners with whom it has contracts, and limit its purchases from the other interest-owners in the pool to like percentages, thereby incurring take-or-pay liability for the volumes it fails to take under its contracts and similarly burdening its interstate customers with these added costs.[12] In either event, the order interferes with the market forces that Congress believed should ultimately govern wellhead sales and "indirectly achieves the * * * result" of "state regulation of the prices of interstate wholesales of natural gas" condemned in *Northern Natural*, 372 U.S. at 91 (footnote omitted).

3. To be sure, the NGPA does not, in so many words, bar state control over wellhead sales in interstate commerce. But congressional silence can hardly support the conclusion that Congress intended to allow the states to exercise authority over such transactions.[13] While Congress clearly meant to replace

---

[12] Had there been no state order, Transco would have been free to avoid or minimize take-or-pay liability by taking no more than contracted-for amounts of gas from the pool.

[13] This, of course, is not to say that the state has no power to check waste and discrimination in the taking of gas from the ground. Indeed, this Court, in *Northern Natural*, 372 U.S. at 94-95 n.12, recognized the existence of that state authority, noting approvingly "proration and similar orders aimed at producers." Thus, as one commentator has observed, state regulatory orders enforcing ratable production in a field at market-demand levels (*i.e.*, true market-demand proration orders) cannot be manipulated for purposes of economic protectionism and would therefore obviate the problem posed by the Mississippi Board's order, which imposes on an interstate pipeline the obligation to purchase more state gas than it requires. Note, *Natural Gas Regulation and Vested Property Interests: Ratable Taking, Proration Standards and Field-*

blanket Commission authority to set prices for sales of gas at the wellhead with the comprehensive scheme of Title I of the NGPA, see *Mid-Louisiana Gas Co.*, 463 U.S. at 332-336, there is not a shred of evidence that it intended, at the same time, to allow the states to substitute their authority for that of the Commission and to regulate wellhead sales.

On the contrary, it appears the preemption principle that this Court recently reiterated is equally applicable here: "a federal decision to forgo regulation in a given area may imply an authoritative federal determination that the area is best left *un*regulated, and in that event would have as much preemptive force as a decision *to* regulate," *Arkansas Electric Cooperative Corp.*, 461 U.S. at 384 (emphasis in original). This, in other words, is a case where " '[t]he scheme of federal regulation [is] so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it,' because 'the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of states laws on the subject.' " *Fidelity Federal Savings & Loan Ass'n* v. *De La Cuesta*, 458 U.S. 141, 153 (1982) (quoting *Rice* v. *Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)). The legislative background, pp. 12-13, *supra*, confirms that these principles govern here.

---

wide Civil Liability, 62 Tex. L. Rev. 691, 722-723 (1983). See also Sections 503, 505 of the NGPA, 15 U.S.C. 3413, 3415; 124 Cong. Rec. 38366 (1978) (remarks of Rep. Dingell, House manager of the NGPA, explaining that state authority to pro-rate production is unaffected by NGPA). We certainly do not challenge the state's authority to achieve its conservation goals through alternatives that do not interfere with federally-protected interests.

Indeed, when Congress intended to allocate regulatory authority to the states in the NGPA, it clearly knew how to do so. In Section 602(a) of the Act, 15 U.S.C. 3432(a), Congress allowed states to impose price ceilings (less than the NGPA maximum price, but not higher) over first sales of gas, but only if the gas is produced and sold in intrastate commerce. See H.R. Conf. Rep. 95-1752, 95th Cong., 2d Sess. 124-125 (1978).[14] In light of this carefully limited grant of state authority, it is inconceivable that Congress meant, sub silentio, to cede any additional Commerce Clause authority to the states.

B. The State's Regulation Of Transco's Purchasing Practices Directly Conflicts With The Commission's Regulatory Responsibilities Under The NGPA And The Natural Gas Act

Because, as we have shown, Congress enacted Title I of the NGPA to free wellhead sales of natural gas from the very type of utility regulation the state has sought to impose here, that regulation is invalid under traditional preemption principles. But even if Congress's intent to eliminate such regulation were less clear, the state Board's order would be invalid because it conflicts with the Commission's authority, granted to it by Congress under both the NGPA and the Natural Gas Act, to regulate what this Court has described in *Northern Natural* as "the intricate re-

---

[14] This Court has explained that under this provision the states are limited to establishing maximum prices for intrastate sales which do not exceed the NGPA maximum lawful price "in accordance with the overall national policy." *Energy Reserves Group, Inc.* v. *Kansas Power & Light Co.*, 459 U.S. 400, 421 (1983); see also *Exxon Corp.* v. *Eagerton*, 462 U.S. 176, 186-187 (1983).

lationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States." 372 U.S. at 92.

In *Northern Natural* this Court set aside orders, quite similar to those at issue here, requiring ratable takes from Kansas wells, on the ground that the "orders necessarily deal with matters which directly affect the ability of the Federal Power Commission [now FERC] to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act." 372 U.S. at 91-92. As this Court there explained:

> The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas, or for state regulations which would indirectly achieve the same result * * *.
>
> The danger of interference with the federal regulatory scheme arises because these orders are unmistakably and unambiguously directed at *purchasers* who take gas in Kansas for resale after transportation in interstate commerce. * * * Moreover, any readjustment of purchasing patterns which such orders might require of purchasers who previously took unratably could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States.

Ibid. (emphasis in original; citation and footnote omitted).

The state order in this case suffers from the very infirmity that invalidated the ratable-take orders in

Northern Natural. Here, as there, the State's order is tantamount to "state regulation of the prices of interstate wholesales of natural gas," 372 U.S. at 91; and here, as there, the state regulation must fall.

While the Mississippi Supreme Court ruled that the state Board may not set the wellhead price because it had not been authorized to do so by the state legislature (J.S. App. 48a-55a), it nonetheless effectively gave the Board that power and more. It did so by upholding state requirements that Transco purchase volumes of deregulated gas in excess of volumes the pipeline had contracted to buy (or might even need), or alternatively subject itself to take-or-pay liabilities. Thus, enforcement of the state rule will affect more than simply the price Transco pays in actually buying the deregulated gas. By controlling Transco's overall gas purchasing practices, the Board's order weakens substantially the effect of any attempt the pipeline otherwise might make to minimize the overall cost of its customers' gas. In this way, the Board's order raises the prices Transco's interstate customers must pay for gas.[15]

---

[15] The Mississippi Supreme Court described this effect very clearly when, in referring to Transco's right under Section 601(c) of the NGPA to pass its costs of purchasing gas through to the consumer, that court observed (J.S. App. 37a-38a):

> it is not Transco who experiences a burden, it is the consumer. If higher purchasing prices at the wellhead lead to higher prices to the consumer and a loss of markets, this is simply one inevitable consequence of the free market policies of the era of deregulation * * *.

That court's fundamental error is that under its ruling the "inevitable consequence" of higher consumer prices is not a function of free market policies; rather, the higher prices are the direct result of state regulation. And it is this error which

The state courts focused only on what the Commission could *not* regulate under the NGPA—the wellhead price set by contract between producers and Transco—while ignoring the impact of the Board's order on the pipeline's customers. As the State Supreme Court stated its rationale:

> FERC has no authority to intervene when the pipeline, denied pass through [under Section 601 (c)], seeks to get out of its deal with the producers. Though the price paid at the wellhead may well be FERC-determined excessive as the product of fraud or collusion when pass through is sought, it remains a just and reasonable price *as a matter of law* as between the pipeline and the producer. 15 U.S.C. § 3431(b)(1)(A). Nothing in the pass through provisions of NGPA continues in effect any FERC jurisdiction over wellhead first sales of deregulated natural gas.

J.S. App. 27a (emphasis in original).[16]

Proper analysis of a pipeline's purchasing practices does not, however, focus on the wellhead transaction between the producer and the pipeline; it focuses, as this Court recognized in *Public Service Commission* v. *Mid-Louisiana Gas Co.*, *supra*, on the very different regulatory context of the pipeline's relationship with its downstream customers:

> The NGPA is designed to preserve the Commission's authority under the [Natural Gas Act]

---

brings the state into direct conflict with the Commission's regulatory duties.

[16] The lower state court stated the matter more succinctly: "FERC still has no authority or jurisdiction (not even under Section 601(c)) to regulate or control a pipeline's purchase of [Section] 107 gas, or the price the pipeline pays to producers or the pipeline's contract with producers" (J.S. App. 74a).

> to regulate natural gas sales from pipelines to their customers; however, it is designed to supplant the Commission's authority to establish rates for the wholesale market, the market consisting of so-called 'first sales' of natural gas.

463 U.S. at 331. So examined, the state action in this case stands in the way of the Commission effectuating its significant statutory duties.

First, the state order tends to frustrate the Commission's exercise of its statutory authority under Section 601(c)(2) to deny a pipeline pass through of wellhead prices because of "fraud, abuse or similar grounds." [17] This is so because the state has dictated what Transco's wellhead gas purchasing practices should be. Thus, a practice that the Commission, under the statute, might have found to be an "abuse" meriting a denial of pass through if done at the pipeline's own initiative—the purchase of expensive deregulated gas when alternative lower-cost supplies were available—is a required practice by order of

---

[17] The Commission has opened inquiries into pipeline purchasing practices under the "fraud, abuse, or similar grounds" standard of Section 601(c)(2) in approximately 16 cases. See, *e.g.*, *Transcontinental Gas Pipeline Corp.*, 23 F.E.R.C. ¶ 61,292 (1983), 26 F.E.R.C. ¶ 61,361 (1984).

The Commission construed the Section 601(c)(2) standard in *Columbia Gas Transmission Corporation*, 26 F.E.R.C. ¶¶ 61,034 and 61,334 (1984), appeal pending *sub nom. Office of the Consumers' Counsel* v. *FERC*, No. 84-1099 (D.C. Cir. filed Mar. 16, 1984). In that case, the Commission explained Section 601(c) and its right of guaranteed pass through as carrying with it "the duty of the pipeline to take reasonable actions to minimize gas costs [to its customer]" and stated that "[t]he statutory limitation on automatic pass through on grounds of fraud or abuse should be interpreted in light of this duty." 26 F.E.R.C. at 61,100.

The Commission further ruled that the term "abuse" was meant to include "circumstances where a pipeline's gas acqui-

the State. In giving the Commission the authority to deny pass through only under the "fraud, abuse or similar grounds" standard, Congress implemented a policy of generally allowing the free market to operate so that pipelines minimize their gas costs, while at the same time market incentives provide increased natural gas production.[18] Since the State's regulation requiring purchases of specific volumes of high-cost gas frustrates the ability of pipelines to minimize gas costs and limits the Commission's authority to monitor pipeline purchasing practices under the "fraud, abuse or similar grounds" standard of Section 601(c)(2), that regulation " 'stands as an obstacle to the accomplishment and execution' " of the statutory purpose. *Lodge 76, International Association of Machinists*, 427 U.S. at 151 (quoting *Hill* v. *Florida*, 325 U.S. 538, 542 (1945)).

Second, the Board's order conflicts with the Commission's related statutory authority under Section 601(c)(2)(B) of the NGPA, 15 U.S.C. 3431(c)(2)(B), to assure that the pipeline's pass through of its gas costs is consistent with rules implementing the

---

sition policies and practices evidence a reckless disregard of the pipeline's fundamental duty to provide service at the lowest reasonable cost and such policies have significant, adverse consequences." 26 F.E.R.C. at 61,000.

The Commission also ruled that other traditional remedies are available under the Natural Gas Act to deal with "imprudent" purchasing practices. See 26 F.E.R.C. ¶¶ 61,034 and 61,334 (1984).

[18] Indeed, the Congressional goal of linking pass through to minimization of gas costs is underscored by the "affiliated entities limitation" of Section 601(b)(1)(E), which, as this Court noted in *Mid-Louisiana Gas Co.*, 463 U.S. at 340, links the "justness and reasonableness" of the price a pipeline pays for gas from its affiliate to comparable first sales between persons *not* affiliated with the pipeline.

incremental pricing provisions of Title II of the NGPA.[19]

Congress has emphasized that "recovery [under Section 601(c)] must be consistent with incremental pricing," H.R. Conf. Rep. 95-1752, 95th Cong., 2d Sess. 124 (1978). Incremental pricing was designed by Congress to eliminate any incentive for pipelines to bid excessively high prices for deregulated supplies, relying on the relatively low price of gas remaining under control to moderate the prices charged its customers.[20] As Representative Dingell, House manager of the NGPA, explained:

---

[19] Title II directs the Commission "to establish, monitor, and enforce a mandatory pipeline accounting and billing system that will result in a surcharge on sales of gas used [for certain industrial uses]. The amount of the surcharge is to be determined by the difference between part of the costs of acquiring certain categories of high cost gas and the price of an appropriate alternative fuel" (Haase, *The Federal Role in Implementing the Natural Gas Policy Act of 1978*, 16 Houston L. Rev. 1067, 1075 (1979)).

[20] Thus, the NGPA provides that deregulation of high-cost gas cannot take effect until the effective date of the first incremental pricing rule. See Section 121(b) of the NGPA, 15 U.S.C. 3331(b). *Consumer Energy Council of America* v. *FERC*, 673 F.2d 425, 434-437 (D.C. Cir. 1982).

In September 1979, the Commission adopted the Phase I Rule required by the statute, applying incremental pricing to industrial boiler fuel users. See *FERC Order No. 49*, 8 F.E.R.C. ¶ 61,333 (1979). However, its Phase II Rule, making incremental pricing applicable to all industrial users not specifically exempted by statute, was rejected by Congress's use of the legislative veto. That Congressional veto, however, was found unconstitutional. *Consumer Energy Council of America* v. *FERC*, *supra*. The Commission's Phase I Rule remains in effect. See 18 C.F.R. Pt. 282. Under that Rule, the Commission has allowed the states to implement their own substitute

> Incremental pricing * * * focus[es] initial price increases on the pipelines' most price sensitive customers: historically underpriced industrial users. By allowing the delivered price of these customers' gas to rise to the level of alternative fuels, incremental pricing limits the ability of the pipeline to pass through high prices for new gas. *Constrained by the limits this places upon the passthrough of increased costs of gas, pipelines will be forced to bid responsibly for deregulated supplies of gas or face a loss of customers and an associated reduction in throughput volumes and profits.*

124 Cong. Rec. 38361 (1978) (emphasis added). Accordingly, an integral part of the incremental pricing system established by Title II of the NGPA is its reliance on market forces to control the wellhead price of high cost gas. The state ratable take rule substitutes state regulation for the free market necessary to make the incremental pricing provisions operate as Congress intended.

In Section 601(a)(1)(B) of the NGPA, 15 U.S.C. 3431(a)(1)(B), Congress provided that the Commission's jurisdiction under the Natural Gas Act should not apply "solely by reason of any first sale" of deregulated gas. Far from creating a regulatory gap to be filled in at the State's option, it is clear that Section 601(a) is part of a carefully limited restructuring of the Commission's authority in a new, integrated regulatory system. The manifest purpose

---

incremental pricing plans, subject to Commission approval. See 18 C.F.R. 282.208. This Commission action is the subject of challenge in the District of Columbia Circuit. See *American Paper Institute* v. *FERC*, No. 81-1071 (argued Jan. 27, 1982).

of Section 601(a) was to exclude the first sale by independent procedures of certain gas, like the deregulated Section 107 gas involved here, from the certification and tariff (wellhead pricing) authority of the Commission under the Natural Gas Act that followed the decision in *Phillips Petroleum Co.* v. *Wisconsin*, *supra* (see pp. 11-13, *supra*).[21] There is not the slightest hint that Section 601(a) was intended to go further and abrogate the Commission's traditional Natural Gas Act responsibility to regulate the relationship between a pipeline *and its system customers*, the responsibility implicated here and in this

---

[21] The legislative history of Title I of the NGPA makes entirely clear that the major focus of congressional concern was on the regulatory difficulties arising out of the effort to implement the decision in the *Phillips* case. See, *e.g.*, S. Rep. 95-436, 95th Cong., 1st Sess. 7-9 (1977); H.R. Rep. 95-496, 95th Cong., 1st Sess. Pt. 4, at 89-90 (1977); 123 Cong. Rec. 2141-2142 (1977) (remarks of Sen. McClure); *id.* at 19964-19965 (remarks of Rep. Kemp), see also H.R. 8444, 95th Cong., 1st Sess. § 401 (1977) (Findings and Purposes). Indeed, the House Bill included a section that would have amended the definition of "natural-gas company" in Section 2(6) of the Natural Gas Act, 15 U.S.C. 717a(6), to exclude any person making sales under certain enumerated sections of the bill. The amendment would effectively have overruled *Phillips* by excluding certain producer sales from Commission regulation under the Natural Gas Act. H.R. 8444, *supra*, § 416. See H.R. Rep. 95-496, *supra*, at 109. The Conference Report explains that the NGPA "limits the jurisdiction of the Commission under the Natural Gas Act in a manner similar to the House-passed bill." H.R. Conf. Rep. 95-1752, *supra*, at 123. Accordingly, Section 601(a)(1)(D), 15 U.S.C. 3431(a)(1)(D), provides that if a person's sales of certain gas are excluded from the Commission's Natural Gas Act jurisdiction by virtue of Section 601(a)(1)(A)-(C), that person shall not be included within the definition of "natural-gas company" in the Natural Gas Act.

Court's decision in *Northern Natural.* See *Mid-Louisiana Gas Co.*; *Exxon Corp.* v. *Eagerton*, 462 U.S. at 184-186; *Columbia Gas Development Corp.* v. *FERC*, 651 F.2d 1146, 1149-1150 (5th Cir. 1981).

II. THE BOARD'S ORDER IMPERMISSIBLY INTERFERES WITH INTERSTATE COMMERCE

A. Aside from preemption concerns, the Board's order impermissibly burdens interstate commerce since its effect is to secure a larger share of the interstate gas market for high-cost gas produced in Mississippi and thereby to increase revenues to Mississippi producers at the expense of out-of-state customers. This sort of economic protectionism is flatly prohibited under the Commerce Clause.

More than sixty years ago this Court held that "[n]atural gas is a lawful article of commerce and its transmission from one State to another for sale and consumption in the latter is interstate commerce." *Pennsylvania* v. *West Virginia*, 262 U.S. 553, 596 (1923). Accordingly, "[a] state law * * * of the State where the gas is produced * * *, which by its necessary operation prevents, obstructs or burdens such transmission is a regulation of interstate commerce,—a prohibited interference." *Id.* at 596-597 (citing cases); see also, *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, 461 U.S. 375, 389-395 (1983); *Exxon* v. *Eagerton*, 462 U.S. at 184. Since, as the Mississippi Supreme Court acknowledged, the Board's order will result in higher gas prices for consumers of gas in other states (J.S. App. 37a-38a), the order is tantamount to the type of economic protectionism that has uniformly been outlawed as an impermissible burden on interstate commerce. See *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 580-582 (1981);

Maryland v. *Louisiana*, 451 U.S. 725, 753-760 (1981); *City of Philadelphia* v. *New Jersey*, 437 U.S. 617 (1978).[22]

Nor does Mississippi's characterization of its rule as a conservation measure excuse it from the operation of settled Commerce Clause principles.[23] Whether a particular state action constitutes an undue burden on the interstate production and transmission of natural gas is measured by the test enunciated in *Pike* v. *Bruce Church, Inc.*, 397 U.S. 137, 142 (1980) (citation omitted):

> Where the statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. * * * If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

---

[22] In addition, the state Board's ratable-take orders obstructs interstate commerce by placing upon purchasers of gas in interstate commerce—*e.g.*, pipelines like Transco—the burden of performing the complex task of balancing the output of the natural gas wells within the State. See *Northern Natural*, 372 U.S. at 92, 98. Although the present case applies the state ratable-take order only to Transco's purchases from the Harper Sand Gas Pool (J.S. App. 57a-58a), the State rule would equally require ratable taking from all wells producing gas from any other pool within the State.

[23] The accuracy of that characterization is at best dubious, since the net effect of the order is to penalize Transco if it fails to take the full production of all the wells in the pool, regardless of its market for that production. See pp. 6, 14-15, *supra*.

See also *Arkansas Electric Cooperative Corp.* v. *Arkansas Public Service Commission*, 461 U.S. 375, 393-395 (1983). Application of this rule establishes the constitutional error of the state order in this case. The State of Mississippi is not without an alternative means of checking waste or discriminatory taking of gas through proration and similar orders directed at producers. See n.13, *supra*. Since means clearly exist by which the State can protect local interests with a lesser impact on interstate activities, the burden imposed by the state Board's order cannot be justified. *Pike* v. *Bruce Church, Inc.*, *supra*.

B. This Court's decision in *Cities Service Gas Co.* v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950), upon which the courts below relied, does not require a contrary result. In that case, the Court upheld an Oklahoma regulation imposing a minimum wellhead price on all gas taken from wells within the state. The Court rejected a Commerce Clause attack on the regulation on the ground that the state regulation represented a reasonable effort to prevent economic and physical waste of natural gas. In finding that this local interest outweighed the national interest, this Court noted that the wellhead price of gas (then 3.6 to 5 cents per Mcf) was "but a fraction of the price paid by domestic consumers at the burner-tip, so that the field price as herein set may have little or no effect on the domestic delivered price" (340 U.S. at 187). The average price for gas at the wellhead has risen to $2.59 per Mcf; that price represents more than 50 percent of the current price of gas at burner-tip.[24] Accordingly, the present field price of gas has

---

[24] In 1983 the wellhead price averaged $2.59 while the delivered price to consumers was $4.82. 1 Energy Information Administration, *Natural Gas Annual 1983*, at 6.

a direct and controlling impact on ultimate consumption of gas, and the considerations that supported the holding in *Cities Service Gas Co.* v. *Peerless Oil & Gas Co.*, *supra*, obviously no longer obtain. See *FPC* v. *Corporation Commission*, 362 F. Supp. 522, 535 (W.D. Okla. 1973), aff'd, 415 U.S. 961 (1974).[25]

CONCLUSION

The judgment of the Supreme Court of Mississippi should be reversed.

Respectfully submitted.

REX E. LEE
Solicitor General

WILLIAM H. SATTERFIELD
General Counsel

JEROME M. FEIT
Solicitor

JOSEPH S. DAVIES
LESLIE J. LAWNER
JOHN H. CONWAY
Attorneys
Federal Energy Regulatory Commission

MAY 1985

---

[25] There was, moreover, no contention in *Cities Service Gas Co.* that the state order was inconsistent with the Natural Gas Act, and this Court made no findings in that regard. See 340 U.S. at 180-182; *Northern Natural*, 372 U.S. at 91 n.9.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1985 461531 10231

Office - Supreme Court, U.S.
FILED
MAY 30 1985
ALEXANDER L. STEVAS,
CLERK

(10)

NO. 84-1076

IN THE
Supreme Court of the United States
OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Petitioner,

V.

STATE OIL & GAS BOARD OF MISSISSIPPI,
ET AL.,
Respondent.

On writ of certiorari to the
Supreme Court of Mississippi

BRIEF OF AMICUS CURIAE,
THE LEGAL FOUNDATION OF AMERICA

DAVID CRUMP
Professor of Law
South Texas College of Law
c/o The Legal Foundation of America
1303 San Jacinto
Houston, Texas 77002
(713) 659-8040
Attorney for Amicus Curiae

21 pp

TABLE OF CONTENTS

TABLE OF AUTHORITIES iii

INTEREST OF AMICUS CURIAE 1

SUMMARY OF ARGUMENT 1

ARGUMENT AND AUTHORITIES 2

I. NEITHER THE NGPA NOR THE NEGATIVE COMMERCE CLAUSE PREVENTS A STATE FROM PREVENTING WASTE, DRAINAGE OR INEQUITY IN THE PRODUCTION OF NATURAL RESOURCES 2

A. *The Rule at Issue is Not Preempted by the Natural Gas Act or Natural Gas Policy Act* 4

B. *The Rule at Issue is Not Prohibited by the Negative Commerce Clause* 6

C. *"Ratable Production" Should Not be Constitutionally Preferred Over Ratable Take* 7

II. STATES SHOULD NOT BE EMPOWERED TO PLACE ONEROUS BURDENS UPON INTERSTATE PIPELINES AND, IN PARTICULAR, SHOULD NOT BE ABLE TO REQUIRE PRICING UNRELATED TO ACTUAL PURCHASE CONDITIONS 11

CONCLUSION 12

APPENDIX: BIBLIOGRAPHY OF ADDITIONAL RECENT AUTHORITIES CONCERNING STATE REGULATION OF INTERSTATE PIPELINE PURCHASER PRACTICES A-1

TABLE OF AUTHORITIES

CASES

Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n, 103 S. Ct. 1905 (1983)	5
Chicago & N.W. Transp. Co. v. Kalo Brick & Tile Co., 450 U.S. 311 (1981)	6
Energy Reserves Group v. Kansas Power & Light Co., 459 U.S. 400 (1982)	5
Florida Lime & Avocado Growers v. Paul, 373 U.S. 132 (1963)	6
FPC v. Sunray DX Oil Co. 391 U.S. 9 (1968)	8
Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456 (1981)	7
Munn v. Illinois, 94 U.S. 113 (1876)	7
Northern Natural Gas Co. v. State Corporation Commission of Kansas, 372 U.S. 84 (1963)	4
Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission, 103 S. Ct. 1713 (1983)	5, 6
Pike v. Bruce Church, Inc., 397 U.S. 137 (1970)	passim
Pogo Producing Co. v. Sea Robin Pipeline Co., No. 84-48823-H (Dist. Ct. Vermillion Parish, La., Feb. 21, 1985), *reported in* Foster Nat. Gas Rep. No. 1509, Mar. 21, 1985	10
Railroad Comm'n Cases, 116 U.S. 307 (1886)	7
Richardson Carbon & Gasoline Co. v. InterNorth, Inc., No. 4-38-534-K (N.D. Tex., Sept. 5, 1984), *reported in* Foster Nat. Gas Rep. No. 1483, Sept. 13, 1984)	10
San Diego Bldg. Trades Council v. Garmon, 359 U.S. 236 (1959)	6
Southport Exploration Co. v. Producers Gas Co., No. 83-C-550B (N.D. Tex., June 6, 1984)	10
Weymouth v. Colorado Interstate Gas Co., 367 F.2d 84 (5th Cir. 1966)	8

STATUTES

Natural Gas Act, 15 U.S.C. (1982) passim
Natural Gas Policy Act, 15 U.S.C. (1982) passim

SECONDARY AUTHORITIES

Court to Decide Gas Sales Authority—Jurisdiction of Natural Gas Sales to Pipelines at Stake, Okla. J., Mar. 26, 1985, at 1, col. 2 5

Hay & Williamson, *Ratable Take, Take-or-Pay, Unilateral Price Adjustments, and Unilateral Market Out* in STATE BAR OF TEXAS, SUING, DEFENDING AND NEGOTIATING WITH OIL & GAS PRODUCERS E-1 (1985) 8

Kuntz, *Correlative Rights of Parties Owning Interests in Common Sources of Supply of Oil & Gas*, 17 INST. ON OIL & GAS TAX'N 217 (1966) 3

P. MACAVOY, PRICE FORMATION IN NATURAL GAS FIELDS 236-37 (1962) 12

E. NEUNER, THE NATURAL GAS INDUSTRY 266-69 (1960) 12

Nordhaus, *Producer Regulation and the Natural Gas Policy Act of 1978*, 19 NAT. RES. J. 830 (1979) 5

Note, *Natural Gas Regulation and Vested Property Interests: Ratable Taking, Proration Standards, and Fieldwide Civil Liability*, 62 TEX. L. REV. 691 (1983) 3

Paschal, *Hearing Examines Gas Ratable Take Powers*, The [Okla.] Journal—Record, Oct. 18, 1984, at 2, col. 1 6

Pierce, *Natural Gas Regulation, Deregulation, and Contracts*, 68 VA. L. REV. 63 (1982) 12

Pierce, *Reconsidering the Roles of Regulation and Competition in the Natural Gas Industry*, 97 HARV. L. REV. 345 (1983) 4

Stinnett, *Contractual and Statutory Liens in the Oil Patch: Perfection and Foreclosure*, in STATE

BAR OF TEXAS, SUING, DEFENDING, AND NEGOTIATING WITH OIL & GAS PRODUCERS E-1 (1985) 10

H. WILLIAMS & C. MEYERS, OIL & GAS LAW sec. 204.3-.4 (1983) 2

NO. 84-1076

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORP.,
Petitioner,

V.

STATE OIL & GAS BOARD OF MISSISSIPPI,
ET AL.,
Respondent.

BRIEF OF AMICUS CURIAE, THE LEGAL FOUNDATION OF AMERICA

INTEREST OF AMICUS CURIAE

The Legal Foundation of America ("LFA") is a nonprofit corporation supporting the operations of a public interest law firm. It has expertise in matters of energy policy and frequently files briefs in energy cases. LFA is located on the campus of, and shares certain activities and personnel with, the South Texas College of Law in Houston.

SUMMARY OF ARGUMENT

I.

Preemption and Commerce Clause Issues. The rule at issue is not preempted by the Natural Gas Act or Natural Gas Policy Act. With respect to this deregulated gas, today's legislative policy is unrelated to (and is only indirectly affected by) the objectives of this Mississippi rule. Nor is this rule prohibited by the negative commerce clause. The rule is non-discriminatory; it seeks to protect important local interests that are not addressed at all by federal law; and its goals could not be equally achieved by lesser means.

Ratable "Production" as Opposed to Ratable "Take". Ratable "production" is not in a status that is preferred to ratable "take" under the Constitution. The legislative choice between the two approaches is exceedingly complex. Arguments by pipeline purchasers and by producers reflect different resolutions of the competing equities. Thus Mississippi was justified in concluding that its policy goals could be achieved by a system of ratable take, but not by one of ratable production. Furthermore, since Mississippi does not attempt to regulate the price at which a pipeline must take, this rule does not interfere with a purchaser's ability to limit its takes to gas it knows it can profitably resell, and thus it does not burden interstate commerce.

II.

Avoidance of Endorsement of Burdensome State Rules. Although the Court should uphold the rule at issue, it should avoid broad endorsement of state rules that might unduly burden gas purchasers. In particular, a purchaser should not be required to take at identical prices from all sellers irrespective of sale conditions. Such a requirement would not be "non-discriminatory." Instead, it would be irrational, since it would prevent the purchaser from considering market circumstances affecting price.

ARGUMENT AND AUTHORITIES

I. NEITHER THE NGPA NOR THE NEGATIVE COMMERCE CLAUSE PREVENTS A STATE FROM PREVENTING WASTE, DRAINAGE OR INEQUITY IN THE PRODUCTION OF NATURAL RESOURCES.

If a single pipeline in a field decides to take from only one among many wells, it will cause drainage of other wells owing to the phenomenon of migration.[1] The law of oil and gas in

---

1 E.g., 1 H. WILLIAMS & C. MEYERS, OIL & GAS LAW sec. 204.3-.4 (1983).

the United States embodies the rule of capture, and adjacent mineral owners are bound to protect their correlative rights. Absent a rule such as the one at issue, these adjacent owners would be unable to produce and sell gas, and they would see gas that lies under their leases produced by the one producing well.[2] Worse, they would suffer a loss of pressure that would ultimately prevent their producing even the gas that remains.

Concerns related to waste and conservation may be affected by these issues. The ultimate effect of reasoning that would reverse this rule would, by the same logic, prevent States from enforcing long-standing rules of conservation. Conversely, if a State can enforce rules relating to field spacing and production allowables,[3] it is difficult to see why it cannot enforce non-discriminatory rules relating to takes from wells by pipelines. Rather than minimizing the role of the States in the regulation of production and pricing of natural gas, Congress, by enacting the Natural Gas Policy Act, expressly

---

2 Id. at sec. 204.6; see also Kuntz, Correlative Rights of Parties Owning Interests in Common Sources of Supply of Oil & Gas, 17 INST. ON OIL & GAS TAX'N 217 (1966). Correlative rights are rights to be protected from uncompensated drainage. For an excellent analysis in the context of the Texas proration system, see Note, Natural Gas Regulation and Vested Property Interests: Ratable Taking, Proration Standards, and Fieldwide Civil Liability, 62 TEXAS L. REV. 691 (1983).

3 Thus, for example, field spacing rules may have a substantial indirect or peripheral impact upon pricing, in the sense that if they were suddenly invalidated and if it were made permissible for every producer to locate wells wherever it desired, there might be temporary reductions in cost of production and hence downward pressure on price. The conservation effects, however, would be catastrophic, as would the inequities inflicted upon adjacent producers, and these effects would soon be felt in long-term price increases.

Such local regulations should not be unconstitutional owing to their indirect effect on price, and neither should ratable take rules.

recognized the power of the States to regulate certain prices (*see* NGPA sec. 602) [4] and certain production-related functions such as the determination of qualification for wellhead pricing categories (*see* NGPA sec. 503). [5]

A. The Rule at Issue is Not Preempted by the Natural Gas Act or Natural Gas Policy Act

Nothing in the NGPA or the NGA prevents the rule at issue. The NGPA contains a complex scheme of price ceilings for wellhead sales of different categories of gas, depending upon the dates when wells were drilled, upon production formations, upon well location, and upon other factors.[6] The NGPA also provides for deregulation (*i.e.*, removal of price ceilings) of certain categories of gas. While the NGA contains provisions regulating the pricing of gas by natural gas companies (including purchased gas allowances and other aspects of pipeline rate design), [7] its provisions with respect to wellhead sales of deregulated gas are supplanted by the NGPA. Thus the reasoning of *Northern Natural Gas Co. v. State Corporation Commission of Kansas*, 372 U.S. 84 (1963), is inapplicable here. [7a]

---

4 15 U.S.C. sec. 3432 (1982).

5 15 U.S.C. sec. 3413 (1982).

6 NGPA secs. 102-109, 15 U.S.C. secs. 3312-3319 (West Supp. 1984). The gas at issue is section 107 gas, which was deregulated in 1979.

7 15 U.S.C. sec. 717f(c) (1982). See generally Pierce, Reconsidering the Roles of Regulation and Competition in the Natural Gas Industry, 97 HARV. L. REV. 345 (1983).

7a The Northern Natural Case was based upon preemption by NGA sec. 1(b).

Section 601(a)(1)(B) of the NGPA, however, declares that "section 1(b) of the Natural Gas Act, the provisions of such Act and the jurisdiction of the [Federal Energy Regulatory] Commission under such Act shall not apply" to, among others, the category of gas defined in section

Similarly, wellhead price deregulation does not embody such a pervasive Congressional judgment against regulation of any kind as to preempt the rule at issue. The Congressional scheme has been interpreted in slightly different contexts to permit state environmental and intrastate pricing regulation. *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission*, 103 S.Ct. 1713 (1983); *Energy Reserves Group v. Kansas Power & Light Co.*, 459 U.S. 400 (1982). Especially given the inclusion in the statute of explicit authorization of re-regulation[8] and the retention of many categories of regulated gas,[9] the NGPA cannot be said to "imply an authoritative federal determination that the area [i.e., takes of deregulated gas] is best left *un*regulated" even to the extent of prohibiting state rules *unrelated* to price. *Cf. Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n*, 103 S. Ct. 1905, 1912 (1983). In summary, the NGPA structure of national prices, and its scheme of price deregulation that is intended to effect the orderly transition to a market system, are not in the least inconsistent with state rules designed to protect local interests in equity among participants or in conservation. A preemption argument based upon such a claimed inconsistency, when considered in the context of the important role discussed above that the NGPA assigns to the States in connection with deregulated gas, would throw out the baby with the bath water.[9a]

107(c)(1) of the NGPA (which is the category here at issue). 15 U.S.C. sec. 3431 (a)(1)(B)(i) (1982).

Thus the NGPA squarely states that the federal regulation deemed preemptive in Northern Natural "shall not apply" to this gas.

8 15 U.S.C. sec. 3332 (1982).

9 Section 104, for example, provides for a variety of ceiling prices for "old" interstate gas. 15 U.S.C. sec. 3314 (1982). See Nordhaus, Producer Regulation and the Natural Gas Policy Act of 1978, 19 NAT. RES. J. 830, 850 (1979).

9a The decision of the issue in question has significant potential for invalidation of necessary regulation in various States under differing statutory systems. See Court to Decide Gas Sales Authority—Jurisdiction of Natural Gas Sales to Pipe-

Nor does FERC authority over purchased gas allowances preempt this state rule, because wellhead sales and pipeline sales have always been the subjects of separate regulatory schemes, and any effect on purchased gas allowances would be indirect and incidental. The state rule at issue does not make federal compliance "a physical impossibility," and it does not "stand as an obstacle" to FERC's objectives with respect to purchased gas allowances, as would be required for preemption in the absence of express language. *Pacific Gas & Electric Co., supra*, 103 S. Ct. at 1722.[10]

B. The Rule at Issue is Not Prohibited by the Negative Commerce Clause

Further, the state rule is not prohibited by the negative commerce clause. The modern rule of *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970), clearly indicates that it should be upheld. First, the rule at issue does not discriminate against interstate commerce; it is, in this respect, "even-handed." *Id.* The effects it will have on interstate commerce are "incidental"

---

lines at Stake, Okla. J., Mar. 26, 1985, at 1, col. 2; Paschal, Hearing Examines Gas Ratable Take Powers, The [Okla.] Journal—Record, Oct. 18, 1984, at 2, col. 1.

The Oklahoma Commission decided that its ratable take system (which differs from Mississippi's in that it is combined with a proration system) was constitutional even in light of Northern Natural, as did the Texas Railroad Commission. See APPENDIX and authorities therein cited.

10 See note 3 supra.

Thus preemption is "not favored 'in the absence of persuasive reasons–either that the nature of the regulated subject matter permits no other conclusion, or that Congress has unmistakably so ordained.'" Chicago & N.W. Transp. Co. v. Kalo Brick & Tile Co., 450 U.S. 311, 317 (1981), quoting Florida Lime & Avocado Growers v. Paul, 373 U.S. 132, 142 (1963). Preemption does not extend to state regulation that is "peripheral" to the federal objective, 450 U.S. at 317, quoting San Diego Bldg. Trades Council v. Garmon, 359 U.S. 236, 243 (1959), or to a subject that is amenable to local regulation and that is one that Congress could have regulated but did not. 450 U.S. at 317.

in the sense that they are not the direct object of the rule and they need not be significant in relation to other factors affecting interstate commerce. *Id.* There is a "legitimate local purpose" in the prevention of waste, drainage, and inequity. *Id.*

Given these conditions, the question becomes "one of degree," according to *Bruce Church.* The extent of the burden that will be tolerated depends on two factors: (1) "the nature of the local interest involved" and (2) "whether it could be promoted as well with a lesser impact on interstate commerce." *Id.*

The local interest is strong, in that absent some sort of state intervention, the issues of drainage and waste of natural resources simply would not be addressed by any law. Neither is the subject of federal regulatory protection (nor should either be). [11] The protection and preservation of natural resources is a state interest of the first magnitude, *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456 (1981), as is the regulation of local actions of businesses affected with the public interest, *Munn v. Illinois*, 94 U.S. 113 (1876); *see also Railroad Comm'n Cases*, 116 U.S. 307 (1886). Furthermore, as the Mississippi Supreme Court pointed out, it is entirely appropriate for the State to address preventable inequities due to these issues.

C. "Ratable Production" Should Not be Constitutionally Preferred Over Ratable Take

The issue remains whether the local interest "could be promoted as well with a lesser impact on interstate commerce." *Bruce Church, supra*, 397 U.S. at 142. It has been suggested that a lesser impact could result if Mississippi used "ratable production" limits rather than ratable take requirements. Ratable production limits the producer, while ratable take limits the

---

11 See note 10 supra.

pipeline.[12] It is respectfully submitted, however, that ratable production can itself have dysfunctional effects. The subject is controversial, and the propriety of ratable production is currently the subject of pending litigation.[13] The Court should not require States to adopt it as a matter of constitutional law.

(1) Pipeline Arguments. The argument of pipelines in favor of ratable production concerns the interplay between take-or-pay clauses, ratable take, and production by a number of producers within a single field. A take-or-pay clause is a contractual provision that requires a ". . . pipeline, over a stated period of time, to take an average amount of gas, or to pay for it." *FPC v. Sunray DX Oil Co.*, 391 U.S. 9, 47 n. 39 (1968); *see also Weymouth v. Colorado Interstate Gas Co.*, 367 F.2d 84, 96 (5th Cir. 1966).[14] The prepaid gas is not lost to the purchaser but is normally subject to "makeup" or recoupment at a later date. A take-or-pay clause may be part of the bargained-for consideration in a long-term contract, and it provides the producer with reliable cash flow that it may depend upon to finance its production.

A take-or-pay clause in a contract with one producer may require the pipeline to take or pay for a certain percentage of that producer's deliverable capacity. Pipelines argue, however, that if ratable take then requires them to extend their takes to every other producer in the field at the same substantial percentages of

---

12 The APPENDIX to this brief contains a list of recent authorities concerning the problems of ratable take, ratable production, and take-or-pay, including the opinions of the Oklahoma Corporation Commission and Texas Railroad Commission.

See also Hay & Williamson, Ratable Take, Take-or-Pay, Unilateral Price Adjustments, and Unilateral Market Out in STATE BAR OF TEXAS, SUING, DEFENDING AND NEGOTIATING WITH OIL & GAS PRODUCERS E-1 (1985). Cf. Note, supra note 2.

13 This litigation is based upon various producer arguments against ratable production. See notes 17-18 infra and accompanying text.

14 See also authorities cited in the APPENDIX, below.

deliverable capacity, they may be unable to market the gas so purchased. A take-or-pay clause with one producer may prevent the pipeline from lowering the percentage take, and thus it may be unable to avoid what it regards as excessive purchases from other producers under a ratable take requirement.[15] Pipelines claim that allowable or ratable production can balance the market. Pipelines further argue that these concerns are increased when there is a gas "bubble" or oversupply, as there has recently been.[16] It is for these reasons that pipelines make arguments for "allowables" or ratable production, which limit the quantity each producer can produce, instead of ratable take.

There are several aspects of the Mississippi approach that lessen these problems. First, the price at which ratable taking from other producers is done is not regulated except by a standard of good faith. Thus a pipeline such as Transco is not bound to pay the same price to others in the field, but may take into account market conditions, and it may thus balance supply and demand by taking at prices at which it knows that it *can* indeed resell. This feature of the Mississippi rule tends to minimize the problem of excessive takes. Furthermore, Mississippi places no other burdensome conditions upon takes of gas by pipelines. This rule preserves their flexibility completely and does not place any significant burden on purchases of gas in interstate commerce.

(2) Producer Arguments. Some producers further contest these pipeline arguments and argue that a scheme of ratable production should not be used to avoid the bargained-for effect of take-or-pay clauses or monthly minimums in their contracts. A producer may argue that it relies upon the cash flow assured by take-or-pay to finance the very production at issue. Alternatively, producers may argue that they have undertaken other subsequent exploration or production ventures in similar reliance

---

15 But cf. Pierce, infra note 19, at 78-79.

16 In 1984, the lower-48-State gas "bubble" was estimated at 2.3 trillion cubic feet. FOSTER NAT. GAS REP. NO. 1470, June 14, 1984, at 10-11 (reporting American Gas Ass'n estimate).

on the contracted-for payments. In some cases, courts have granted temporary restraining orders to producers facing this problem. *Cf. Richardson Carbon & Gasoline Co. v. InterNorth, Inc.*, No. 4-38-534-K (N.D. Tex. Sept. 5, 1984), *reported in* Foster Nat. Gas Rep. No. 1483, Sept. 13, 1984, at 11. Producer insolvency could easily result in some such cases.[17]

Another problem is that, in some instances, reduced takes—whether caused by ratable production or by a pipeline's own action—can damage reservoirs. Thus in *Pogo Producing Co. v. Sea Robin Pipeline Co.*, No. 84-48823-H (Dist. Ct. Vermilion Parish, La., Feb. 21, 1985), *reported in* Foster Nat. Gas Rep. No. 1509, Mar. 21, 1985, at 7, a district court issued a temporary injunction to prevent a pipeline from reducing takes required by a monthly minimum clause because, as the court found, the partial shutdown of the water-drive wells at issue "has permanently damaged and will continue to damage the reservoirs since some of the gas can never be recovered."[18] In summary, producers may consider that their contract interests and reliance interests would be harmed by the required adoption of ratable production, which they argue avoids the anticipated effects of their agreements. *See also Southport Exploration Co. v. Producers Gas Co.*, No. 83-C-550B (N.D. Tex. June 6, 1984) (take or pay clause enforced).

This position is supplemented by the fact that, in some States, *both* ratable take and ratable production are required by rules. In such jurisdictions, the producer's production is limited by production limits, but pipelines are required to take ratably. In such a jurisdiction, mere ratable production is not enough to protect the producer against drainage because absent

---

17 "In recent years, the judicial system has been inundated by litigation involving . . . insolvency in oil and gas operations." Stinnett, Contractual and Statutory Liens in the Oil Patch: Perfection and Foreclosure, in STATE BAR OF TEXAS , supra note 12, at D-1.

18 For a description of the problems of water-drive fields and ratable take, see Note, supra note 2, at 736 nn. 186-87.

a requirement of "fair-share" taking, the pipeline could take only from others in the field and refuse to take from a given producer. Thus the fact that each producer is subject to limits would provide no protection of the interest in fair-share takes.

(3) Federalism. The issue is complex, but at the very least it can be said that ratable production is not superior to ratable take for the purposes Mississippi seeks. A decision by Mississippi that ratable take is to be required simply cannot achieve the same objectives if replaced by a ratable production or "allowables" scheme. In a federal system, the negative commerce clause should not prohibit this choice. A constitutional rule should not determine the outcome unless the alternative is unambiguously superior.

II. STATES SHOULD NOT BE EMPOWERED TO PLACE ONEROUS BURDENS UPON INTERSTATE PIPELINES AND, IN PARTICULAR, SHOULD NOT BE ABLE TO REQUIRE PRICING UNRELATED TO ACTUAL PURCHASE CONDITIONS.

The Mississippi Supreme Court held that the state oil and gas board lacked statutory authority to require nondiscriminatory prices, meaning identical prices irrespective of purchase conditions. Although reached as a matter of state law, that decision also conformed to federal law. While this Court should uphold reasonable requirements of ratable take, it should also prevent States from imposing burdensome or irrational requirements on interstate pipelines, including requirements that they take at prices not reflecting existing market or contract conditions. These conclusions follow from the same authority analyzed to uphold ratable takes above, particularly the NGA, the NGPA, and the *Bruce Church* test.

Natural gas is typically sold on long-term contracts. Such contracts historically have been demanded not by producers, but by pipeline purchasers, who have sought a dependable source

of supply.[19] The length of the contract term is an important item of negotiation. A long term locks up supply for the purchasers, but it prevents the producer from selling elsewhere; hence a producer usually receives price consideration for entering into a long-term contract.[20] This contract feature, along with pricing terms, take-or-pay clauses, renegotiation clauses, and other provisions, all have an influence on the applicable price. So do such factors as well location and access, quality of gas, and ease of administration of the contract. Finally, market price varies with time; demand differs sharply with season, and price is heavily influenced by under- or over-supply.

A price that would burden an interstate pipeline's ability to consider these factors would not be "nondiscriminatory;" instead, it would be irrational. Producers who refused to enter into long-term contracts could "ride the market," seeking higher prices while assured of identical treatment to long-term sellers if prices fell. No producer would wish to commit supply. Furthermore, the difficulty of administering and complying with a state-level regulatory scheme that would set prices by reference to all relevant factors would be so burdensome that it would conflict with the NGA-NGPA scheme and with the *Bruce Church* test.

CONCLUSION

This honorable Supreme Court should not hold the rule at issue to be preempted by the NGA or NGPA. Nor should it hold the rule to be prohibited by the negative commerce clause. The rule serves important state interests that are not protected by federal law; its effects on interstate commerce

---

19 See E. NEUNER, THE NATURAL GAS INDUSTRY 266-69 (1960); Pierce, Natural Gas Regulation, Deregulation, and Contracts, 68 VA. L. REV. 63, 77-78 (1982).

20 Thus Professor MacAvoy, in a study of gas contracts, found that longer term contracts were associated with higher prices. P. MACAVOY, PRICE FORMATION IN NATURAL GAS FIELDS 236-37 (1962); cf. Pierce, supra note 19, at 77-78.

and upon the objectives of federal law are diffuse and indirect, and they are not the purpose of the rule; and its objectives cannot be achieved equally by an approach with lesser impact on interstate commerce. At the same time, however, the Court should not broadly sanction state regulation that would unduly burden interstate pipelines. In particular, a requirement that a pipeline take at identical prices from each producer irrespective of existing market conditions would be irrational and should not be authorized.

Respectfully submitted,

David Crump
Professor of Law
South Texas College of Law
1303 San Jacinto
Houston, Texas 77002
(713) 659-8040
Counsel of Record

APPENDIX

BIBLIOGRAPHY OF ADDITIONAL RECENT AUTHORITIES CONCERNING STATE REGULATION OF INTERSTATE PIPELINE PURCHASER PRACTICES

Annot., Validity of Imposition, By State Regulation, of Natural Gas Use Priorities, 84 A.L.R.3d 541 (1978).

Annot., What Constitutes "Production and Gathering of Natural Gas" Excluded from Coverage of Natural Gas Act, 15 U.S.C. sec. 717, 44 A.L.R.Fed. 823 (1979).

Armstrong, State Ratable Take Orders Do Not Limit Pipeline Take-or-Pay Obligations (Producer's Viewpoint), in Take-or-Pay, Proration and Ratable Takes, Evolution in the Natural Gas Industry (New York, Executive Enterprises Inc., 1985).

Brief of the Oil and Gas Conservation Division, Oklahoma Corporation Commission, No. 28770 (Okla. Corp. Comm. March 30, 1983).

In Re Whether the Oklahoma Corporation Commission Has the Authority to Require Ratable Take of Natural Gas by First Purchasers Who Are Interstate Pipelines, No. 28770, Order No. 254451 (Okla. Corp. Comm. Sept. 4, 1984) (Report of Hearing Panel).

Douglas, Ratable Take, Market Out Considerations and Railroad Commission Response, Including Take-or-Pay, in 10th Ann. Oil, Gas & Min. L. Institute (Austin, Texas, University of Texas School of Law, 1984).

Edwards, Current Trends in Gas Marketing and Regulatory Responses, in 32nd Ann. Min. L. Institute (Baton Rouge, Louisiana State University Law Center, 1985).

Friday, The Clash Between State Proration and Ratable Take Orders and Federal Regulation of Interstate Gas Pipelines, in

Take-or-Pay, Proration and Ratable Takes (New York, Executive Enterprises Inc., 1985).

Friday, The Effects of State Proration and Ratable Take Orders on Producer-Pipeline Disputes During the Gas Surplus, in Natural Gas Contract Disputes and Litigation (New York, Executive Enterprises Inc., 1984).

Gist, State Ratable Purchase Orders—Conflict with the Natural Gas Act, 17 Sw. L.J. 631 (1963).

Haase, The Federal Role in Implementing the Natural Gas Policy Act of 1978, 16 Houston L. Rev. 1067 (1979).

Inquiry Into Purchasing Practices of Interstate Pipelines, FERC Docket No. RP83-96-000 (1983) (Statement of Patrick H. Martin, Commissioner of Conservation, State of Louisiana; Statement of C. E. Lamb on behalf of Conoco Inc.; Statement of James Townsend, Member, Oklahoma Corporation Commission; Statement of Indicated Producers; Statement of Phil Dick, Kansas Corporation Commission; Statement of Scott Anderson, Texas Independent Producers and Royalty Owners Association; Statement of William J. Murray, Texas Railroad Commission; Statement of Arlon Tussing, President, Arta, Inc.).

5 E. Kuntz Oil and Gas secs. 70.1-70.3 (1978).

Long, Enforcement of Gas Purchase Obligations—Seller's Perspective, in New Developments in Natural Gas Contracting (New York, Executive Enterprises Inc., 1984).

Memorandum from Patrick H. Martin, Commissioner of Conservation, State of Louisiana, Using Producer Nominations for Establishment of Allowables Under Order 29-F (June 2, 1983).

Meyers, Federal Preemption and State Conservation in Northern Natural Gas, 77 Harv. L. Rev. 689 (1964).

Miles, The Meaning of the Southland Exclusion—Complexity and Ambiguity in the Natural Gas Policy Act, 58 Tex. L. Rev. 435 (1980).

Mobil Oil Exploration & Producing Southeast Inc., FERC Docket No. CI77-41-000, 18 FERC Para. 61,266 (1982) (FERC Declaratory Order).

Moody & Garten, The Natural Gas Policy Act of 1978: Analysis and Overview, 25th Ann. Rocky Mtn. Min. L. Inst. 2-1 (1979).

Morrison, Producer Considerations When Gas Is Not Being Sold, in New Developments in Natural Gas Contracting (New York, Executive Enterprises Inc., 1984).

Note, Conservation of Natural Gas and the Federal-State Conflict, 64 Yale L. Rev. 888 (1964).

Pierce, Issues in Gas Contract Litigation, 35th Ann. Inst. on Oil & Gas Law and Taxation (Sw. Legal Fdn., 1984).

Report of the Advisory Committee on Proration and Ratable Take, Railroad Commission of the State of Texas (July 15, 1983).

1 American Gas Association, Regulation of the Gas Industry, Section 12.12, Matthew Bender & Co. (1984).

Taylor, The Excess Gas Market—Recent Legal Problems Precipitated by Excess Deliverability and Applicable Regulatory Provisions, 35th Ann. Inst. on Oil & Gas Law and Taxation (Sw. Legal Fdn. 1984).

Rucker, The Federally Enforceable Delivery Obligation—More Uncertainty for Natural Gas Producers, 16 Houston L. Rev. 1171 (1979).

Office - Supreme Court, U.S.
FILED
MAY 30 1985
ALEXANDER L. STEVAS,
CLERK

No. 84-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL & GAS BOARD OF MISSISSIPPI
AND COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal From The Supreme Court Of The State Of Mississippi

BRIEF FOR THE INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA AS AMICUS CURIAE

JOHN H. CHEATHAM, III
Vice President &
General Counsel
1660 L Street, N.W.
Washington, D.C. 20036
(202) 293-5770

HAROLD L. TALISMAN
WRIGHT & TALISMAN, P.C.
1050 17th Street, N.W.
Suite 600
Washington, D.C. 20036
(202) 331-1194

Attorneys for
Interstate Natural Gas Association of America

May 30, 1985

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

24 pp

TABLE OF CONTENTS

	Page
INTEREST OF THE INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA	1
CONSENT OF THE PARTIES	4
STATEMENT	4
SUMMARY OF ARGUMENT	6
ARGUMENT	8
I. The Mississippi State Board's Order Directed At Pipeline Purchasers Violates The Supremacy Clause By Trespassing Upon The FERC's Continuing And Exclusive Jurisdiction To Regulate Interstate Natural Gas Pipeline Operations	8
II. In Deregulating Certain First Sales Congress Did Not Intend To Open The Door To State Regulation Of Interstate Pipeline Purchases	14
III. The Mississippi Board's Order Is Invalid Under The Commerce Clause	16
CONCLUSION	19

TABLE OF AUTHORITIES

CASES — Page

Atlantic Refining Co. v. *Public Service Comm'n*, 360 U.S. 378 (1959) 11

Cities Service Gas Co. v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950) 10

Columbia Gas Transmission Corp., 26 FERC ¶ 61,031 (1984) 3

Dean Milk Co. v. *City of Madison, Wisconsin*, 340 U.S. 349 (1950) 17

Energy Reserves Group, Inc. v. *Kansas Power & Light Co.*, 459 U.S. 400 (1983) 15

Exxon Corp. v. *Eagerton*, 462 U.S. 176 (1983) 15, 16

FPC v. *Louisiana Power & Light*, 406 U.S. 621 (1972) 14

Maryland v. *Louisiana*, 451 U.S. 725 (1981) 11, 16

Miller Bros. Co. v. *Maryland*, 347 U.S. 340 (1947) ... 18

National Ass'n of Recycling Indus., 660 F.2d 795 (D.C. Cir. 1981) 13

Northern Natural Gas Co. v. *State Corp Comm'n of Kansas*, 372 U.S. 84 (1963) ..... *passim*

Pike v. *Bruce Church*, 397 U.S. 137 (1970) 17

Public Service Comm'n of New York v. *Mid-Louisiana Gas Co.*, 463 U.S. 336 (1983) 15

CONSTITUTIONS, STATUTES AND REGULATIONS

UNITED STATES CONSTITUTION:

Article I, Section 8, Clause 3 (Commerce Clause) *passim*

Article VI, Clause 2 (Supremacy Clause) 6, 7

NATURAL GAS ACT OF 1938, 15 U.S.C. § 717-717W:

15 U.S.C. § 717, *et seq* 2

Section (1)(b), 15 U.S.C. § 717(b) ..... *passim*

NATURAL GAS POLICY ACT OF 1978, 15 U.S.C. § 3301-3432:

15 U.S.C. § 3301, *et seq* 4

Section 601(a)(1), 15 U.S.C. § 3431(a)(1) ..... *passim*

Table of Authorities Continued

	Page
Section 601(a)(2), 15 U.S.C. § 3431(a)(2)	4
Section 105(a), 15 U.S.C. § 3315(a)	15
MISCELLANEOUS	
Energy Information Administration, Department of Energy, *Statistics of Interstate Natural Gas Pipeline Companies*, Table 20 (1983)	3
H.R. Conf. Rep. No. 95-1752 (1978)	15
J. Sutherland, *Statutes and Statutory Construction*, § 46.06 at 63 (C. Sands 4th Ed. 1973)	13
S. Conf. Rep. No. 85-1126 (1978)	15
Statement of Policy and Interpretive Rule, *Regulatory Treatment of Payments Made In Lieu of Take-or-Pay Obligations*, issued April 10, 1985, pp. 4-5, 50 Fed. Reg. 16076	3
Take-Or-Pay Provisions In Gas Purchase Contracts, Statement Of Policy, 47 Fed. Reg. 57268, issued December 23, 1982	11

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL & GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., *et al.*
Appellees.

On Appeal from the Supreme Court of the State of Mississippi

BRIEF FOR THE INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA AS AMICUS CURIAE

This brief *amicus curiae* is filed pursuant to Rule 36 in support of Appellant's request for reversal of the judgments below.

INTEREST OF THE INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

The Interstate Natural Gas Association of America (INGAA) is a non-profit national trade association whose mem-

bership includes virtually all of the major natural gas pipeline companies subject to the Federal Energy Regulatory Commission's (Commission)[1] jurisdiction under the Natural Gas Act (NGA), 15 U.S.C. § 717, *et seq.* For many years, INGAA has appeared in rulemaking, rate and certificate proceedings before the Commission and the courts when issues affecting the general interests of its members and of the natural gas industry were involved. A list of INGAA's membership is set forth in the appendix to this brief.

The Mississippi Supreme Court's decision here on appeal upholds the Mississippi State Oil and Gas Board's (Board) Order No. 409-82,[2] issued pursuant to its Rule 48, insofar as the Board orders Appellant, Transcontinental Gas Pipe Line Corporation (Transco), to purchase gas ratably from all other producers in the Mississippi gas fields here involved, even those with which Appellant has no contracts.[3] The Board's order comes at a time when Appellant and other interstate gas pipelines are experiencing excess gas deliverability and facing "take or pay" liabilities to producers of

---

[1]The term "Commission," when used in the context of action taken prior to October 1, 1977, refers to the Federal Power Commission; when used otherwise, the reference is to the Federal Energy Regulatory Commission.

[2]Order No. 409-82 is attached as Appendix C to Appellant's Jurisdictional Statement.

[3]The Mississippi Supreme Court's decision is reported at 457 So.2d 1298 (Miss., 1984) and is reproduced in Appendix A (referred to herein as App. A) to Appellant's Jurisdictional Statement. The Court reversed Order No. 409-82 insofar as it sought to regulate the price for the gas that Transco would be required to take from non-contract producers. Instead the Court required Transco to pay a "reasonable price" (App. A, pp. 48a-55a).

unprecedented dimension.[4] Unless overturned, the order will not only exacerbate this serious crisis as to Appellant and other interstate pipelines purchasing gas in Mississippi and the consumers ultimately served by those pipelines, but will serve to sanction similar state actions.[5] Because of the national importance of this case to the interstate gas industry and the ultimate consumers of gas, INGAA is filing this brief as *amicus curiae*.

---

[4]The critical nature of the take-or-pay problem was described by the Commission in *Columbia Gas Transmission Corp., et al.*, 26 FERC ¶61,031, at 61,081 (1984):

> As of December 31, 1982, for example, 18 interstate pipelines had already filed to recover in rates the carrying costs on over $700,000,000 in take-or-pay prepayments. By November 30, 1983, claimed gas prepayments totaled approximately $775,000,000. Estimates of the total potential prepayment liability for pipelines as a whole over the next two to three years are staggering.

As of December 31, 1983, the take-or-pay prepayment balances reported by major pipelines totalled approximately $1 billion. Energy Information Administration, Department of Energy, *Statistics of Interstate Natural Gas Pipeline Companies*, Table 20 (1983).

Gas purchase contracts between producers and pipelines generally contain take-or-pay provisions requiring the pipeline to take, or else pay for, a certain portion of the gas tendered by the producer. The contracts usually provide for a certain period in which the pipeline can make-up the volumes not taken. In pipeline ratemaking, such prepayments for gas not taken are reflected in the cost of service as a part of the working capital upon which the pipeline is allowed its cost of capital. *Regulatory Treatment of Payments Made in Lieu of Take-or-Pay Obligations*, Statement of Policy and Interpretative Rule, issued April 10, 1985, pages 4-5, 50 Fed. Reg. 16076.

[5]This brief does not address the validity of conservation rules or orders in states other than Mississippi, which may operate differently and have a different impact on the pipeline.

CONSENT OF THE PARTIES

INGAA has obtained the consent of the parties to this appeal for filing its brief *amicus curiae*. The consent statements are attached to the original signed copy of the brief filed with this Court.

STATEMENT

INGAA relies on the more complete statement of the case in the brief filed by Appellant.

The Mississippi Supreme Court's decision holds that the state may regulate the gas purchasing pattern of an interstate pipeline system to require it to take gas ratably, if at all, from producers in the Mississippi gas fields here involved, even from those producers who do not have a contract with the pipeline (App. A, p. 291a).

On the question of preemption, the Court concludes that this Court's decision in *Northern Natural Gas Company* v. *State Corporation Commission of Kansas*, 372 U.S. 84 (1963), striking down a similar Kansas ratable take regulation because of conflict with the Federal Power Commission's jurisdiction under the NGA, is no longer a bar to state regulation because of the intervening enactment of the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. § 3301, *et seq.*, particularly Section 601(a), [15 U.S.C. § 3431(a)(1)], deregulating first sales of the high-cost natural gas here involved (App. A, p.26(a)):

> Section 601(a)(1) [15 U.S.C. § 3431(a) (2)] means what it says - the Natural Gas Act of 1938 (NGA) and FERC's jurisdiction under the Act *never* apply to deregulated gas, and certain other categories of gas. That message is decisive of the preemption issue in this case. The reason the Supreme Court voided the ratable take order in *Northern Natural* was because at that par-

> ticular point in time such an order substantially affected gas which was subject to the FPC's (FERC's) jurisdiction under the NGA. If the NGA and the FERC's jurisdiction under the NGA no longer extend to deregulated gas, and FERC has no authority to regulate the first sales and purchases of deregulated gas either directly or indirectly, then *Northern Natural* does not dictate a preemption of otherwise existing state authority. (Emphasis in original)

The Court further concludes that Congress in deregulating first sales of the gas under the NGPA did not preclude state regulation of the wellhead sales of deregulated gas (App. A, p. 29a):

> Our study of the terms and provisions of the Natural Gas Policy Act of 1978, however, convinces us that the Congress has not proscribed state regulation of wellhead sales of deregulated gas. However consistent a continued proscription on state regulation might have been with the theoretical underpinnings of deregulation, the Congress in NGPA in 1978 did not ban state regulation of deregulated gas. What, and all, the Congress has done insofar as we are concerned is strip away federal regulatory authority thus leaving in effect and wholly exercisable such state regulatory authority as otherwise exists. The lynchpin that holds *Northern Natural* together having been removed, and not having not been replaced by a congressional enactment that wellhead prices of deregulated gas be left unregulated by the states as well, Transco's preemption claim fails. The states today have the authority to require that an interstate pipeline company take deregulated gas ratably and without discrimination in favor of one owner, operator or producer and against another in the same common source of supply. *Cities Service Gas Co.*

v. *Peerless Oil & Gas Company*, 340 U.S. 179, 185, 71 S.Ct. 215, 219, 95 L.Ed. 190, 201 (1950).

On the question of whether the Board's order is prohibited by the Commerce Clause, the Court held that, although the order can impose a burden on interstate commerce by increasing prices to consumers, "Congress within the scope of its power under the affirmative Commerce Clause has expressly authorized such increases" in enacting the NGPA. Moreover, the Court concludes that the burden is of Appellant's own making because of the take-or-pay provisions in its contracts and "[i]f higher purchasing prices at the wellhead lead to higher prices to the consumer and a loss of markets, this is simply one inevitable consequence of the free market policies of the era of deregulation with respect to which Transco is vested by the negative Commerce Clause with no right to complain" (App. A, p. 38).

Finally, the Court declined to consider whether a less burdensome alternative adequate to protect local interests could have been chosen by the State on the ground that such an inquiry is not called for "until it first be established that the regulation in question creates an unreasonable burden on interstate commerce" (App. A, p. 38).[6]

SUMMARY OF ARGUMENT

I. In concluding that this Court's decision in *Northern Natural* is no longer controlling because of the intervening deregulation provisions of the NGPA concerning the gas here involved, the Mississippi Supreme Court misconceives

---

[6]Article VI, clause 2 ("Supremacy Clause") and Article I, Section 8, clause 3 ("Commerce Clause") of the Constitution of the United States and the pertinent statutory provisions of NGA and NGPA to this appeal are set forth in Appendix G of Appellant's Jurisdictional Statement.

the scope of deregulation under the NGPA and the holding under *Northern Natural*. While the NGPA did remove the Commission's certificate and rate authority concerning first sales of certain categories of gas, it did not alter the Commission's exclusive jurisdiction under Section 1(b) 15 U.S.C. § 717(b), of the NGA, over pipeline transportation which was the focal point of conflict in the *Northern Natural* case. The Board's order in this case, like the similar ratable take order in the *Northern Natural* case, violates the Supremacy Clause because it is directed in its impact and effect at the pipeline purchaser and not at the producer and thereby directly conflicts with the Commission's exclusive jurisdiction to regulate pipeline transportation under Section 1(b) of the NGA. As a condition to obtaining gas under contract from the fields here involved, the order would force Transco to buy gas it may not need or want from non-contract producers. Therefore, the order is not merely incidental to the regulation of the production of gas for conservation purposes.

II. Nor is there any basis for the Court's conclusion that, by implication, Congress intended in the NGPA to remove the historical barriers to direct state regulation of interstate pipelines. To the contrary, the NGPA extended federal authority to include intrastate sales and where Congress intended to cede Commerce Clause authority to the states, it did so expressly - which is not the case here.

III. Moreover, by requiring the pipeline to buy gas that it may not need or want from non-contract producers as a condition to buying gas under contract from the fields here involved, and thereby exposing the pipeline to an increase in its cost of service, the Board's order violates the Commerce Clause by placing an impermissible and unjustified burden on interstate commerce in the name of state conservation. In evaluating this burden, it was clear error for the Mis-

sissippi Supreme Court to refuse to consider that there are other conservation alternatives available to the state that could protect local interests without burdening interstate commerce.

ARGUMENT

I.

The Mississippi State Board's Order Directed At Pipeline Purchasers Violates The Supremacy Clause By Trespassing Upon The FERC's Continuing And Exclusive Jurisdiction To Regulate Interstate Natural Gas Pipeline Operations

In concluding that the deregulation provision of Section 601(a), 15 U.S.C. § 3431(a)(1), of the NGPA "is decisive of the preemption issue in this case," the Court rationalizes that: "If the NGA and FERC's jurisdiction under the NGA no longer extend to deregulated gas, and FERC has no authority to regulate the first sales and purchases of deregulated gas either directly or indirectly, then *Northern Natural* does not dictate a preemption of otherwise existing state authority" (App. A, p. 26a). The defect in this rationale, however, is that, while Section 601(a)(1) of the NGPA did deregulate certain categories of first sales of gas, it did not eliminate the Commission's NGA jurisdiction over pipeline transportation and sales which is central to the preemption question in this case, as it was in *Northern Natural*.

It is correct, as the Court points out, that Section 601(a)(1) of the NGPA removes the Commission's rate setting and certificate jurisdiction over the categories of first sales in this case. It is also correct that the Commission, under the NGPA, cannot deny a pipeline the authority to "pass-through" to its customers the prices it pays at the wellhead, unless the Commission "determines that the amount paid [by the pipeline] was excessive due to fraud,

abuse or similar grounds" (App.. A, p. 27a). However, it is not correct that a "comparison of Rule 48 with federal law reveals no point of natural conflict" (App. A, p. 27a).

In *Northern Natural*, the conflict which this Court was concerned with was not the conflict between the Kansas ratable take order and the Commission's NGA jurisdiction over the sale of the gas by producers, but rather the Commission's traditional NGA jurisdiction over pipelines (372 U.S. at 92):

> The danger of interference with the federal regulatory scheme arises because these orders are unmistakably and unambiguously directed at *purchasers* who take gas in Kansas for resale after transportation in interstate commerce. In effect, these orders shift to the shoulders of interstate purchasers the burden of performing the complex task of balancing the output of thousands of natural gas wells within the State, cf. *Miller Bros. Co.* v. *Maryland*, 347 U.S. 340, 74 S.Ct. 535, 98 L.Ed. 744 - a task which would otherwise presumably be the State Commission's. Moreover, any readjustment of purchasing patterns which such orders might require of purchasers who previously took unratably could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States. This relationship is a matter with respect to which Congress has given the Federal Power Commission paramount and exclusive authority. See *Federal Power Comm'n* v. *Hope Natural Gas Co.*, 320 U.S. 591, 610, 64 S.Ct. 281, 291, 88 L.Ed. 333.[7]

---

[7]Unless otherwise stated, emphasis is in the original.

After reviewing other cases dealing with state conservation orders, including *Cities Service Gas Co.* v. *Peerless Oil & Gas Co.*, 340 U.S. 179 (1950), relied on by the Court below, this Court explained that (372 U.S. at 94):

> . . . our cases have consistently recognized a significant distinction, which bears directly upon the constitutional consequences, between conservation measures aimed directly at interstate purchasers and wholesales for resale, and those aimed at producer and production. The former cannot be sustained when they threaten, as here, the achievement of the comprehensive scheme of federal regulation.

As in *Northern Natural*, the state order here in question is directed in its impact and effect at the interstate pipeline purchasers, and not at the producers. As in *Northern Natural*, the state order would interfere with the pipeline "purchasing patterns" which "could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States."

The Board's order confronts Transco and other pipeline purchasers similarly situated with the same Hobson's choice described in *Northern Natural*[8] at a time when Transco and the interstate natural gas pipeline industry as a whole, are faced with more gas deliverability under contract than can currently be marketed. Transco's undesirable choices are to (1) increase its takes above the gas it wants or needs from the non-contract producers in the Mississippi fields until they become ratable with the highest amount that Transco is obligated to take from under its contract minimum take obligation with a contract pro-

[8]Dissenting opinion, 372 U.S. at 99, footnote 1.

ducer in the same field; or (2) continue to take the same amount from the field as a whole but reallocate its takes so as to make them ratable by reducing its takes below contract minimum from those producers who have contracts with Transco. In the first instance, in order to take the non-contract volumes which it does not need or want, Transco would have to cut-back on its purchases from contract producers in other producing areas, thereby increasing its exposure of having to pay for gas which it cannot take under the minimum take provisions of those contracts. In the second instance, Transco would have to reduce its purchases from contract producers in the field in order to take the volumes from the non-contract producers, thereby again exposing itself to having to pay for gas which it cannot take from the contract producers.[9] It is this adverse interference and impact of the State's order on the pipeline's operations that conflicts with the Commission's jurisdiction and responsibility to regulate pipeline operations toward the goal of obtaining an adequate supply of natural gas for the interstate market "at the lowest possible reasonable rate consistent with the maintenance of adequate service." *Atlantic Refining Co.* v. *Public Service Comm'n*, 360 U.S. 378, 388 (1959); *Maryland* v. *Louisiana*, 451 U.S. 725, 748-9 (1981).[10]

[9]As mentioned earlier, this brief does not address the impact or operation of conservation rules or orders in states other than Mississippi.

[10]Indeed, the necessary purchase requirements from non-contract producers to satisfy Rule 48 conflicts with the Commission's Statement of Policy issued December 16, 1982 on take-or-pay provisions in gas purchase contracts. 47 Fed. Reg. 57268 (Dec. 23, 1982). Recognizing that take-or-pay contract obligations may be shielding the prices of deregulated and other higher cost gas from market constraints, the Commission announced a policy against any new or modified contracts containing provisions for take-or-pay liability in excess of 75

The Court goes too far in construing Section 601 of the NGPA as removing all incidents of Commission jurisdiction simply because this gas has been deregulated, including Commission jurisdiction over pipeline operations under Section 1(b) of the NGA, which was the point of conflict in *Northern Natural*. Accepting the Court's statement that Section 601(a)(1) of NGPA "means what it says," it does not say, as the Court concludes, that "the Natural Gas Act of 1938 (NGA) and FERC's jurisdiction under the Act *never* apply to deregulated gas, and certain other categories of gas" (App. A., p. 26a). To be sure, as to the categories of gas addressed in subparagraphs (A) and (B) of Section 601(a)(1), that Section states that "for purposes of Section 1(b) of the Natural Gas Act, . . . the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply" to the specified categories of natural gas (App. A, p. 25a). However, that language cannot be read alone, for it goes on to say that the NGA jurisdiction which is being removed by Section 601(a)(1)(A)(B) is expressly limited to that which exists "*solely* by reason of any *first* sale of such natural gas." (15 U.S.C. § 3431(a)(1)(A)(B))

This limitation is reemphasized in Subparagraph 601(a)(1)(D) of the NGPA which parallels Subparagraphs 601(a)(1)(A) and (B) in exempting from "natural gas company" jurisdiction those persons as to whom NGA jurisdic-

---

percent of annual deliverability from the producers' wells. Under the policy, there is a rebuttable presumption that prepayments will not be reflected in rates if the prepayments are made pursuant to new contracts or amendments which exceed the 75 percent annual deliverability limit. Under Rule 48, however, pipelines could be required to take in excess of 75 percent deliverability from non-contract producers if they purchase their minimum take-or-pay volumes from producers in the same gas pool under existing contracts entered into prior to December 16, 1982, containing a take-or-pay requirement in excess of 75 percent of deliverability.

tion would have applied but for the exemptive provisions of Subparagraphs (A) or (B). Again, the "solely by reason of" language used in Subparagraph (D) to refer to Subparagraphs (A) and (B) effectively counters the Court's conclusion.

By treating the phrase "solely by reason of" as if it is absent from Paragraph 601(a)(1), the Court's interpretation violates the "elementary rule of construction that effect must be given, if possible, to every word, clause and sentence of a statute." 2A J. Sutherland, *Statutes and Statutory Construction*, § 46.06 at 63 (C. Sands 4th ed. 1973) (quoting *State ex rel First National Bank of Crete* v. *Bartley*, 39 Neb. 353, 58 N.W. 172, 174 (1984)); *see National Ass'n of Recycling Indus.*, v. *ICC*, 660 F.2d 795, 799 (D.C. Cir. 1981).

What Congress was careful to spell out in Paragraph 601(a)(1) of the NGPA was that, of the several occasions for NGA jurisdiction over the sale and transportation of natural gas in interstate commerce, *solely* that jurisdiction arising out of the "first sale" of natural gas was being affected by Paragraph 601(a)(1). That is, where NGA jurisdiction would have attached "solely by reason of any first sale of such natural gas," such jurisdiction was limited by the NGPA. More specifically, *solely* the certificate and rate-setting powers over certain categories of producer sales were removed.

Moreover, Congress was careful in Section 601 to distinguish between the Commission's sales jurisdiction and transportation jurisdiction. Thus, Subsection 601(a) entitled "Jurisdiction of the Commission under the Natural Gas Act" has two paragraphs. Paragraph (1) is entitled "Sales," and Paragraph (2) is entitled "Transportation." The

Commission's transportation jurisdiction, which the Court ignores, was left virtually untouched by the NGPA.[11]

Thus, contrary to the Court's conclusion, Congress did not place beyond the Commission's regulatory reach all incidents of the categories of gas enumerated in Paragraph 601(a)(1) of the NGPA. Congress merely stated that the Commission has no NGA Section 1(b) jurisdiction "*solely* by reason of any first sale of such natural gas." Section 1(b) of the NGA gives the Commission jurisdiction over (1) the transportation of natural gas in interstate commerce, (2) the sale for resale of natural gas in interstate commerce, and (3) natural gas companies engaged in such transportation or sale. "Each of these is an *independent* grant of jurisdiction . . ." *FPC* v. *Louisiana Power & Light*, 406 U.S. 621 at 636 (1972). Congress' careful wording in Paragraph 601(a)(1) affected only the "first sale" level of jurisdiction, and left undisturbed the Commission's jurisdiction over all other attributes of interstate commerce respecting the enumerated categories of gas, *i.e.*, interstate transportation by natural gas companies and their subsequent sales for resale. The presence of those attributes triggers Commission jurisdiction which preempts the Board's order in this case.

II.

In Deregulating Certain First Sales Congress Did Not Intend To Open The Door To State Regulation Of Interstate Pipeline Purchases

While the Court states (App. A, p. 29a) that its study of the NGPA "convinces us that Congress has not proscribed

---

[11]Paragraph 601(a)(2) of the NGPA, entitled "Transportation," changed the Commission's NGA Section 1(b) transportation authority only in certain limited areas not pertinent here. What is pertinent, however, is that Paragraph 601(a)(2) evidences the fact that where Congress intended to limit the Commission's NGA transportation authority, it said so in express terms.

state regulation of wellhead sales of deregulated gas," it cites no evidence that Congress intended to cede to the states the authority asserted here to regulate interstate pipeline purchases.

Where Congress intended in the NGPA to cede authority to the states, it did so expressly. Thus, in extending federal authority to include ceiling prices for first sales in intrastate commerce, 15 U.S.C. § 3315(a) (Supp. IV), Congress provided the states with authority as to such intrastate sales "to establish or enforce any maximum lawful price for first sale of natural gas produced in such state which does not exceed the maximum lawful price" established by the NGPA. *Exxon Corp.* v. *Eagerton*, 462 U.S. 176, 185 (1983); *Energy Reserves Group, Inc.* v. *Kansas Power & Light Co.*, 459 U.S. 400, 419 (1983). As to this provision, the House and Senate Conference Reports on the NGPA both stated: "The Congress is ceding its authority under the commerce clause of the Constitution to regulate prices for such production to affected States." S. Conf. Rep. No. 85-1126, p. 125 (1978); H.R. Conf. Rep. No. 95-1752, p. 125 (1978).

In light of the express grant of authority in the NGPA to the states where Congress intended to cede authority, there is no valid basis for assuming that Congress intended, through silence, to open the door to state regulation of interstate pipelines.[12] This is particularly so, in view of the long judicial history invalidating attempted state regulation over interstate pipeline purchasers before and since the passage of the Natural Gas Act.[13] As stated in *Northern Natural*, 372 U.S. at 90:

---

[12]*See Public Service Comm'n of New York* v. *Mid- Louisiana Gas Co.*, 463 U.S. 319, 336 (1983).

[13]See cases cited in *Northern Natural*, 372 at 90.

> "[I]t was settled even before the passage of the Natural Gas Act, that *direct* regulation of the prices of wholesales of natural gas in interstate commerce is beyond the constitutional power of the States - whether or not framed to achieve ends, such as conservation, ordinarily within the ambit of state power."

In *Maryland* v. *Louisiana, supra*, issued after passage of the NGPA, this Court reaffirmed the FERC's exclusive jurisdiction over interstate pipeline regulation in invalidating a state taxing statute because "like the state Commission's order in *Northern Natural Gas, supra*, it is inconsistent with the federal scheme" (451 U.S. at 751). Following *Maryland* v. *Louisiana*, this Court, in *Exxon Corp.* v. *Eagerton*, struck down a "pass-through prohibition" in an Alabama severance tax statute on oil and gas because it interfered with Federal Regulation under the NGA. These cases reinforce the view that Congress left no room for state regulation over interstate pipeline operations.

III.

The Mississippi Board's Order Is Invalid Under The Commerce Clause

In concluding that the Board's order imposes a permissible burden on interstate commerce, the Court reasons that it need not reach the question of whether the state had a less burdensome alternative adequate to protect the local interest because (App. A, p. 38a):

> "The search for such alternatives * * * need not be made in connection with our Commerce Clause inquiry *until it first be established that the regulation in question creates an unreasonable burden on commerce.*" (emphasis supplied)

The obvious defect in this rationale is that, if the regulation is first determined to create "an unreasonable burden on commerce," it moots the need for determining whether the state could have adopted less burdensome alternatives. Thus, under the Court's rationale, the search for alternatives would never be reached, notwithstanding the Court's acknowledgement that under "the *Pike* v. *Bruce* balancing test * * *, the Supreme Court has made it clear that this inquiry [for alternatives] must be taken seriously" (App. A., p. 38a).

It logically follows that, in determining whether a burden on interstate commerce is reasonable under a balancing test, consideration of the alternatives available to the state to carry out its purpose should be part of the process. *Dean Milk Co.* v. *City of Madison, Wisconsin*, 340 U.S. 349, 356 (1950); *Pike* v. *Bruce Church*, 397 U.S. 137, 143 (1970) ("the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and whether it could be promoted as well with a lesser impact on interstate activities"). As this Court stated in *Northern Natural* (372 U.S. at 93):

> the problem * * * is not as to the existence or even the scope of a State's power to conserve its natural resources; the problem is only whether the Constitution sanctions the particular means chosen* * *.

In any case, the Court is wrong in concluding that the burden on interstate commerce imposed by the Board's regulation is permissible. As in *Northern Natural* the regulation here in question would "shift to the shoulders of interstate purchasers the burden of performing the complex task of balancing the output of * * * natural gas wells "* * * - a task which would otherwise presumably be the State Commission's" (372 U.S. at 92). In *Northern Natural*,

this Court indicated that this shift of burden was impermissible, citing by comparison *Miller Bros. Co.* v. *Maryland*, 347 U.S. 340 (1954), holding that the attempted imposition of the collection of a use tax by the state of Maryland upon a Delaware merchandising corporation that sold goods in Delaware to Maryland inhabitants was a violation of the Commerce Clause. Moreover, and more importantly, Rule 48 is statewide and, unless overturned, would force pipelines, during this period of restricted demand and intensive price competition, to increase their cost of service for the reason explained earlier. Unless Rule 48 is overturned, Transco and virtually all over pipelines could be subject to orders from several producing States concerning their purchasing practices in those states.

The Court reasons, however, that, even if the State's rule increases the cost of service to the interstate customer, "Congress within the scope of its power under the affirmative Commerce Clause has expressly authorized such increases" in enacting the NGPA (App. A., pp. 35a-36a). The increases contemplated by the NGPA, however, were not increases emanating from state regulation, but rather increased ceiling prices for gas designed to induce greater exploration and development. Moreover, these increased ceilings were not an end in themselves, but merely a means by which Congress hoped to achieve adequate gas supplies for interstate consumers at a reasonable cost. Thus, state regulation which seeks to impose on a pipeline the burden of purchasing gas which it does not need or want, or to otherwise incur increased take-or-pay costs due to the current oversupply, is not consistent with the goals of the NGPA.

Nor is there any basis for the Court's view that the burden is a burden upon Transco rather than upon interstate commerce and that it is "traceable to its contract with Getty, not to Rule 48" (App. A, p. 36a). As the Court itself

points out, under the NGPA, pipelines are entitled to recover their cost of purchased gas absent a finding of fraud, abuse or similar grounds (App. A, p. 27a). Accordingly, increased costs stemming from Rule 48 will ultimately be borne by the interstate consumer. Moreover, this increased cost is clearly traceable to Rule 48 which is directed in its impact and effect at pipeline purchasers. This cost would not be incurred if the state had adopted constitutionally sanctioned conservation rules directed at the producers, rather than at the pipeline, such as discussed in *Northern Natural* (372 U.S. at 94, n. 12). Indeed, there is no evidence to show, nor even a claim, that, as a result of *Northern Natural*, producing states, such as Mississippi, have been unable to carry out their conservation responsibilities.

CONCLUSION

For the foregoing reasons, the judgments below should be reversed.

Respectfully submitted,

WRIGHT & TALISMAN, P.C.

By _____
Harold L. Talisman

1050 17th Street, N.W.,
Suite 600
Washington, D.C. 20036
(202) 331-1194

JOHN H. CHEATHAM, III
Vice President &
General Counsel
1660 L Street, N.W.
Washington, D.C. 20036

Attorneys for
Interstate Natural Gas Association of America

May 30, 1985

Office - Supreme Court, U.S.
FILED
MAY 30 1985
ALEXANDER L. STEVAS,
CLERK

No. 84-1076

IN THE
Supreme Court of the United States
OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

BRIEF AMICUS CURIAE OF ASSOCIATED GAS DISTRIBUTORS IN SUPPORT OF APPELLANT

FREDERICK MORING
Counsel of Record
M. LISANNE CROWLEY
CROWELL & MORING
1100 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 452-5800
Attorneys for Amicus Curiae Associated Gas Distributors

May 30, 1985

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

ASSOCIATED GAS DISTRIBUTORS
MEMBER COMPANIES

Atlanta Gas Light Co.
Baltimore Gas & Electric Co.
Bay State Gas Co.
The Berkshire Gas Co.
Boston Gas Co.
The Brooklyn Union Gas Co.
Central Hudson Gas & Electric Corp.
Chesapeake Utilities Corp.
City of Holyoke, Mass., Gas & Electric Dept.
City of Norwich, Dept. of Public Utilities
City of Westfield Gas & Electric Light Dept.
Colonial Gas Co.
Commonwealth Gas Co.
Concord Natural Gas Corp.
Consolidated Edison Company of New York, Inc.
Delmarva Power & Light Co.
Elizabethtown Gas Co.
EnergyNorth, Inc.
Essex County Gas Co.
Fitchburg Gas & Electric Light Co.
Lynchburg Gas Co.
New Jersey Natural Gas Co.
New York State Electric & Gas Corp.
North Carolina Natural Gas Corp.
Northeast Georgia Municipal Gas Utilities
Northeast Utilities
Northern Utilities, Inc.
Pennsylvania Gas & Water Co.
Pequot Gas Co.
Philadelphia Electric Co.
Philadelphia Gas Works
Providence Gas Co.
Public Service Company of North Carolina, Inc.
Public Service Electric & Gas Co.
South County Gas Co.
South Jersey Gas Co.
The Southern Connecticut Gas Co.
UGI Corporation
Valley Gas Co.
Washington Gas Light Co.

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF AMICUS CURIAE	1
CONSENT OF THE PARTIES	2
SUMMARY OF ARGUMENT	3
ARGUMENT	4
I. THE REGULATION OF INTERSTATE GAS PIPELINE PURCHASING PRACTICES HAS BEEN PREEMPTED BY FEDERAL LAW	4
A. The Federal Energy Regulatory Commission's Responsibility To Regulate Interstate Pipelines, Mandated By The Natural Gas Act, Remains Unaffected By Passage Of The NGPA	4
B. Enforcement Of The Mississippi Ratable Take Order Will Collide With The FERC's Exercise Of Its Pipeline Regulatory Responsibilities	10
II. THE REGULATION OF INTERSTATE PIPELINES IS PARTICULARLY LIKELY TO AFFECT NATIONAL ENERGY INTERESTS, AND THEREFORE REQUIRES A UNIFORM, COMPREHENSIVE SCHEME OF FEDERAL REGULATION	16
A. State By State Regulation Of Pipeline Purchasing Practices Will Impose Substantial Burdens Upon The Interstate Gas Market	16
B. The Growth Of Divergent State Regulation Of Pipeline Purchasing Practices Will Have Unjust And Oppressive Consequences For The Nation's Gas Consumers	18
CONCLUSION	20

TABLE OF AUTHORITIES

Cases: Page

Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, 461 U.S. 375 (1983) 9, 20
Atlantic Refining Co. v. Public Service Commission of New York, 360 U.S. 378 (1959) 6, 18
Burbank v. Lockheed Air Terminal, 411 U.S. 624 (1973) 18
Exxon Corp. v. Eagerton, 462 U.S. 176 (1983) 5, 10
FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944) 19
FPC v. Louisiana Power & Light Co., 406 U.S. 621 (1972) 19
Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132 (1963) 15
Hines v. Davidowitz, 312 U.S. 52 (1941) 16
Maryland v. Louisiana, 451 U.S. 725 (1981) ...9, 10, 15, 18
Maryland People's Counsel v. FERC, No. 84-1090 (D.C. Cir. May 10, 1985) 13, 20
Missouri ex rel. Barrett v. Kansas Natural Gas Co., 265 U.S. 298 (1924) 5
Northern Natural Gas Co. v. State Corporation Commission, 372 U.S. 84 (1963) ..... *passim*
Pacific Gas and Electric Co. v. State Energy Resources Conservation and Development Commission, 461 U.S. 190 (1983) 15
Pennsylvania v. West Virginia, 262 U.S. 553 (1922) 19
Public Service Commission of Kentucky v. FERC, 610 F.2d 439 (6th Cir. 1979) 19
Transcontinental Gas Pipe Line Corporation v. The State Oil & Gas Board of Mississippi and Coastal Exploration, Inc., et al., 457 So.2d 1298 (Miss. 1984) 4, 8, 16, 19

TABLE OF AUTHORITIES—Continued

Decisions and Orders of the Federal Energy Regulatory Commission: Page

Columbia Gas Transmission Corporation, Docket No. TA81-1-21, *et al.*, Opinion Nos. 204 and 204-A, 26 FERC ¶ 61,034 (January 16, 1984) and 26 FERC ¶ 61,334 (March 16, 1985), *appeal docketed, Office of the Consumers' Counsel, State of Ohio v. FERC*, No. 84-1099 *et al.* (D.C. Cir.).. 6, 11, 12, 15

El Paso Natural Gas Company, Docket Nos. RP82-33, *et al.*, Order on Rehearing Modifying Prior Orders, Consolidating Cases, and Setting Hearing, 26 FERC ¶ 61,366 (March 21, 1984) 12

MIGC, Inc., Docket Nos. RP84-15-000, *et al.*, Order Accepting Filing, Consolidating Proceedings, and Setting Matters for Hearing, 26 FERC ¶ 61,369 (March 21, 1984) 12

Panhandle Eastern Pipe Line Company, Docket No. TA84-1-28-002, Order Establishing Hearing Procedures, 26 FERC ¶ 61,339 (March 16, 1984) 12

Southern Natural Gas Company, Docket Nos. TA84-1-7-000, *et al.*, Order Consolidating Proceedings and Setting Matters for Hearing, 26 FERC ¶ 61,371 (March 21, 1984) 12

Transcontinental Gas Pipe Line Corporation, Docket Nos. TA83-2-29-001, *et al.*, Order Establishing Hearing Procedures on Deferred Purchasing Practices Issues, 26 FERC ¶ 61,361 (March 21, 1984) 12

Transcontinental Gas Pipe Line Corporation, Docket Nos. TA85-1-29-000 and TA85-1-29-001, Order Accepting and Suspending Proposed Tariff Sheets Subject to Refund and Conditions, 29 FERC ¶ 61,148 (October 31, 1984) 14

Order Accepting and Suspending Proposed Tariff Sheets Subject to Refund and Conditions, Setting Matters for Hearing, and Consolidating Dockets, 31 FERC ¶ 61,129 (April 20, 1985) 14

TABLE OF CONTENTS—Continued

Page

Trunkline Gas Company, Docket Nos. TA83-1-30-002, *et al.*, Order Setting Matter for Hearing and Consolidating Proceedings, 26 FERC ¶ 61,363 (March 21, 1984) 12

United States Constitution:

Article I, Section 8, clause 3 ("Commerce Clause") 5, 19
Article VI, Section 2 ("Supremacy Clause") 15, 20

United States Statutes:

Natural Gas Act of 1938, 15 U.S.C. § 717 (1982) ..... *passim*
Section 1(b) 3, 5
Section 4 ..... 3, 5
Section 5 ..... 3, 6
Section 7 ..... 3, 13
Natural Gas Policy Act of 1978, 15 U.S.C. §§ 3301-3432 (1982) ..... *passim*
Section 601(a)(1) 8
Section 601(c)(2) 11

State Statutes:

LA. REV. STAT. ANN. § 30:42 (West 1975) 17
OKLA. STAT. ANN. tit. 52, § 823 (West 1969) 17
TEX. NAT. RES. CODE ANN. § 111.083 (Vernon 1978) 17
TEX. NAT. RES. CODE ANN. § 111.086 (Vernon 1978) 17

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

BRIEF AMICUS CURIAE OF ASSOCIATED GAS DISTRIBUTORS IN SUPPORT OF APPELLANT

INTEREST OF AMICUS CURIAE

Associated Gas Distributors (AGD) is an unincorporated group whose members (listed on the inside cover of this brief) are gas distribution companies located along the eastern seaboard of the United States from New England through Georgia. Together, the forty companies known as AGD serve over eleven million customers; their annual sales comprise approximately 25 percent of the gas sold through the nation's interstate gas supply network.

Each AGD company purchases its natural gas for resale from one or more of the major, regulated interstate

gas pipeline companies, including the Transcontinental Gas Pipe Line Corporation (Transco), Appellant in this proceeding. A number of AGD members purchase a substantial portion of their gas supply from Transco; these AGD companies are directly affected by any increase in Transco's rates.

The purpose of the present brief *amicus curiae* is twofold. First, AGD seeks to underscore the historical and continuous federal preemption of the regulation of interstate gas pipeline companies. In particular, we note that at this moment there exists an imminent possibility of collision between the Mississippi ratable take rule enforced against Appellant, Transco, and a ruling sought in a proceeding at the Federal Energy Regulatory Commission (FERC or Commission), which is investigating Transco's purchasing practices.

Second, AGD writes to apprise the Court of the critical nature of this issue for consumers of natural gas nationwide who depend upon a comprehensive federal system of regulation of our nation's interstate gas pipeline network. As other states, particularly the larger gas-producing states, begin to enact and/or enforce "ratable take" schemes against interstate pipelines, the consequences for the ultimate consumers, who absorb the increased costs and uncertainties resulting therefrom, may be severe. As public utilities, the members of AGD have an obligation to protect their customers against the payment of excessive and unlawful natural gas prices. Therefore, AGD has a substantial and direct interest in the outcome of this appeal. For this reason, AGD submits this brief *amicus curiae* in support of the Appellant.

CONSENT OF THE PARTIES

AGD has obtained the written consent of the parties to this appeal for its filing of the present brief *amicus curiae*. The consent statements are attached to the original signed copy hereof filed with the Court.

SUMMARY OF ARGUMENT

I. Pursuant to the Natural Gas Act (NGA), specifically Sections 1(b), 4, 5, and 7, the FERC has comprehensive authority to oversee and regulate the purchasing practices of the nation's interstate gas pipelines. In *Northern Natural*, this Court found that that authority preempted state attempts to regulate interstate pipelines by means of "ratable take" laws, such as the Mississippi law at issue here. The subsequent passage of the NGPA, with its gradual scheme of wellhead *price* deregulation, did not affect the FERC's *pipeline* regulatory authority. The regulation of interstate pipeline purchasing practices remains preempted by federal law. Thus, the Mississippi Supreme Court's holding that a state may regulate an interstate pipeline's purchases of NGPA-deregulated gas is erroneous.

The FERC's continuous assertion of regulatory authority over pipeline purchasing practices demonstrates that the NGPA did not affect a withdrawal of federal pipeline regulation. Indeed, the FERC is currently conducting an investigation of the purchasing practices of Appellant Transco—including its purchases of Mississippi gas pursuant to the Oil & Gas Board's order. The outcome of this investigation could be a federal ruling which directly conflicts with the Mississippi law. The enforcement of state ratable take laws, therefore, runs a collision course with federal action.

II. The need for a comprehensive federal system of pipeline regulation is clear given the oppressive consequences which would inevitably result from diverse, conflicting state regulation. These consequences would affect the entire gas industry, as well as the gas-consuming public.

The pipelines would suffer enormous and costly administrative burdens by having to juggle their gas supplies from all producers operating in a common source,

and in some cases from the whole state. Importantly, various producing states have different ratable take schemes. Compliance with several different states' laws at one time may well be impossible.

Finally, given a complex and conflicting web of state regulations, the FERC would be unable to carry out its most fundamental responsibility—the protection of the nation's gas consumers against excessive rates and charges. Unlike the federal agency, state regulatory bodies are charged with promoting the state, not federal, interests. Thus, the interests of out-of-state gas consumers would be ignored by producing state regulators. The federal government's interest in comprehensive, nationwide pipeline regulation, therefore, is continuous and compelling.

ARGUMENT

I. THE REGULATION OF INTERSTATE GAS PIPELINE PURCHASING PRACTICES HAS BEEN PREEMPTED BY FEDERAL LAW.

A. The Federal Energy Regulatory Commission's Responsibility To Regulate Interstate Pipelines, Mandated By The Natural Gas Act, Remains Unaffected By Passage Of The NGPA.

In *Transcontinental Gas Pipe Line Corporation v. The State Oil & Gas Board of Mississippi and Coastal Exploration, Inc., et al.*, 457 So.2d 1298 (Miss. 1984), the Mississippi Supreme Court recognized, correctly, that "[u]ntil 1978 the federal sovereign indisputably had preempted all state regulation of wellhead sales of natural gas." *Id.* at 1304. The court below erred, however, in holding that Congress' passage of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 *et seq.* (1982) (NGPA), lessened the preemptive authority of the federal government, acting through the Federal Energy Regulatory Commission (FERC or Commission), to regulate the purchasing practices of interstate gas pipelines. The

NGPA's gradual scheme of deregulation of first sale or "wellhead" prices of gas limited the FERC's jurisdiction over gas *producers*, but does not provide an entree to the states to begin regulating interstate *pipelines* through so-called "ratable take" laws such as the State of Mississippi's Statewide Rule 48.

The FERC derives its comprehensive authority to oversee and regulate the purchasing practices of the nation's interstate gas pipelines from several sources in the Natural Gas Act of 1938 (NGA), 15 U.S.C. § 717 (1982).[1] The broadest basis of FERC jurisdiction over interstate pipelines is found in NGA Section 1(b). 15 U.S.C. § 717. There, the Commission is given general authority over (a) the transportation of natural gas in interstate commerce, (b) the sale in interstate commerce of natural gas for resale, and (c) companies engaged in such transportation or sale.

Several substantive provisions of the NGA specifically authorize the federal regulation of pipeline purchasing practices. Section 4 of the NGA, 15 U.S.C. § 717(c), governs pipeline rate increase proceedings. In this type

---

[1] Importantly, prior to any federal regulation—or deregulation—of sales for resale, or "wholesale sales," of natural gas in interstate commerce, this Court refused to permit state regulation of interstate pipelines on the ground that it imposed a direct burden on interstate commerce in violation of the Commerce Clause of the Constitution. *See, e.g., Missouri ex rel. Barrett v. Kansas Natural Gas Co.*, 265 U.S. 298 (1924). In enacting the Natural Gas Act of 1938, 15 U.S.C. § 717 (1982), the Congressional committee reports noted that wholesale sales to interstate pipelines

> ". . . have been considered to be not local in character and, even in the absence of Congressional action, not subject to State regulation. *The basic purpose of the present legislation is to occupy this field in which the Supreme Court has held that the States may not act.*" H.R. Rep. No. 709, 75th Cong., 1st Sess. 1-2 (1937); S. Rep. No. 1162, 75th Cong., 1st Sess., 2 (1937) (citations omitted) (emphasis added).

Exxon Corp. v. Eagerton, 462 U.S. 176, 185 (1983).

of case, "interested" parties (gas producers supplying the pipeline, pipeline customers, and consumer representatives) may raise questions concerning the "justness and reasonableness" of the purchasing pattern under which that pipeline either acquired its gas supply in a past period or proposes to acquire gas in the future. The Commission may then respond to these complaints by making appropriate adjustments in the pipeline's approved cost of service.[2]

Under NGA Section 5, 15 U.S.C. § 717(d), the Commission has authority to adjudicate the justness and reasonableness of any pipeline "practice" which is reflected in the rates and charges of that pipeline. If any such practice is found to be unjust, unreasonable or unduly discriminatory, the Commission is required by Section 5 to "fix" the practice "to be thereafter observed." This section provides a basis for Commission action which could well affect a pipeline's gas purchasing practice in a manner inconsistent[3] with state ratable take schemes.

In 1963, this Court was presented with the question whether the State of Kansas had the power to force an interstate pipeline company to take ratably from all Kansas producers connected to its system. *Northern Natural Gas Co. v. State Corporation Commission*, 372 U.S. 84 (1963). The Court first rejected the State's argument that its ratable take order was directed to the "production and gathering" of natural gas, which is exempt from federal regulation under the NGA. The Court then held the Kansas ratable take order invalid on the ground that it "invade[d] the exclusive jurisdiction

---

[2] *See, e.g., Columbia Gas Transmission Corp.*, Docket Nos. TA81-1-21, *et al.*, Opinion No. 204, 26 FERC ¶ 61,034 at 61,096 (January 16, 1984).

[3] Whereas the FERC's primary obligation is to protect gas consumers against "excessive rates and charges," *Atlantic Refining Co. v. Public Service Comm'n*, 360 U.S. 378, 388 (1959), the enforcement of state ratable take legislation has no such purpose.

which the Natural Gas Act has conferred upon the Federal Power Commission over the sale and transportation of natural gas in interstate commerce for resale." *Id.* at 89. The federal regulatory scheme was found to leave no room for either direct or indirect state regulation of the prices of interstate wholesale sales of gas. *Id.* at 91. More importantly, for the purpose of these proceedings, this Court stated that

> [t]he danger of interference with the federal regulatory scheme arises because these orders are unmistakably and unambiguously directed at purchasers who take gas in Kansas for resale after transportation in interstate commerce. In effect, these orders shift to the shoulders of interstate purchasers the burden of performing the complex task of balancing the output of thousands of natural gas wells within the state, cf. *Miller Bros. Co. v. Maryland*, 347 U.S. 340—a task which would otherwise presumably be the State Commission's. Moreover, any readjustment of purchasing patterns which such orders might require of purchasers who previously took unratably could seriously impair the Federal Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States. This relationship is a matter with respect to which Congress has given the Federal Power Commission paramount and exclusive authority. See *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 610.

Id. at 92. The language of this passage clearly indicates the Court's basis for finding that the federal regulatory scheme preempted the state order. That basis was grounded in federal regulation not simply of wellhead prices but of interstate pipeline-purchasers and their purchasing patterns, the readjustment of which could "seriously impair" the Commission's ability to regulate the pipelines' cost structures and sales to wholesale customers, i.e., distributors.

The Mississippi Supreme Court's basis for divergence from this Court's clear statement in *Northern Natural* was the 1978 passage of the NGPA. As described in the opinion below, this legislation combined an extension of federal regulation into the intrastate market for gas with a "comprehensive plan of deregulation" of federal rate-setting for wellhead prices of gas, "in order to provide producers, operators, and pipeline purchasers with the degree of freedom from regulation and the price incentives necessary to encourage discovery and production of more gas and thus alleviate the theretofor seemingly perpetual natural gas shortage." *Transcontinental Gas Pipe Line*, 457 So.2d at 1314-15. The crux of the lower court's holding was that the *Northern Natural* decision was effectively overruled when Congress withdrew the FERC's authority to regulate wellhead prices. It concluded, therefore, that the states may now impose ratable take obligations on the interstate pipelines which purchase gas within their borders.

The Mississippi court's restriction of its holding to gas which was "deregulated" by the NGPA is essentially irrelevant to the question of federal preemption. It also reflects the court's misunderstanding of the effect of the NGPA, for its statement that "the Natural Gas Act of 1938 (NGA) and FERC's jurisdiction under the act *never* apply to deregulated gas," 457 So.2d at 1316, is simply not accurate. The section of the Act cited in support of this broad assertion, Section 601(a)(1), 15 U.S.C. § 3431(a)(1), entitled "Coordination with the Natural Gas Act," states:

> (A) NATURAL GAS NOT COMMITTED OR DEDICATED * * * the provisions of the Natural Gas Act and the jurisdiction of the Commission under such shall not apply to natural gas which was not committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act *solely by reason of any first sale of such natural gas.*

> (B) COMMITTED OR DEDICATED NATURAL GAS * * * for purposes of Section 1(b) of the Natural Gas Act, the provisions of such Act and the jurisdiction of the Commission under such Act shall not apply *solely by reason of any first sale of natural gas* which is committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act and which is—
>
> (i) High cost natural gas * * *

(Emphasis added.) The qualifying phrase "solely by reason of any first sale" indicates that the Commission does not have jurisdiction to regulate the price at which certain gas is sold into interstate commerce. It has no effect on the Commission's jurisdiction to regulate the transportation of natural gas in interstate commerce, *i.e.*, its duty to regulate the pipelines' purchasing patterns and practices. Thus, the Mississippi court's finding that federal deregulation of certain types of *gas* left room for state regulation of interstate *pipelines* is erroneous.

Ironically, the Mississippi Supreme Court itself recognized that Congress' withdrawal of federal regulation of wellhead pricing did not end the inquiry. It quoted this Court's recent statement in *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission* that

> a federal decision to forgo regulation in a given area may imply an authoritative federal determination that the area is best left *un*regulated, and in that event would have as much pre-emptive force as a decision *to* regulate.

461 U.S. 375, 384 (1983) (emphasis in original). Despite this acknowledgment, the court could cite no support whatsoever for its determination that Congress intended to allow the states to exercise authority in an area where it recognized that a federal preemption problem existed.

Nor did the court acknowledge that in *Maryland v. Louisiana*, 451 U.S. 725 (1981), decided *after* the pas-

sage of the NGPA, this Court relied specifically on *Northern Natural.* In *Maryland,* the Court determined that a Louisiana "First Use" Tax on natural gas brought into the state (primarily from the Outer Continental Shelf) which was imposed upon pipelines and eventually passed through to the ultimate consumer, "like the State Commission's order in *Northern Natural,*" was "inconsistent with the federal scheme and must give way." *Id.* at 751. The Court relied heavily on *Northern Natural* for this determination, quoting the passage (excerpted above) which described the detrimental impact of the state requirement upon FERC's "authority to regulate the intricate relationship between the purchaser's cost structures and eventual costs to wholesale customers . . ." *Id.* at 750, *quoting Northern Natural,* 372 U.S. at 92.[4]

In short, the Mississippi Supreme Court erred in finding either that the federal government has withdrawn its comprehensive regulation of interstate pipelines' purchasing practices or that, to the extent it has deregulated the setting of natural gas prices, it permitted the states to enter the field of interstate pipeline regulation.

B. Enforcement Of The Mississippi Ratable Take Order Will Collide With The FERC's Exercise Of Its Pipeline Regulatory Responsibilities.

Recent proceedings at the FERC to investigate the purchasing patterns of various pipelines—under the authority of both the NGA and the NGPA—demonstrate

---

[4] *See also Exxon Corp. v. Eagerton,* 462 U.S. 176 (1983), in which the Court held that an Alabama statute prohibiting passthrough of a state severance tax imposed upon gas producers was preempted by federal law, stating

> Here, as in *Maryland v. Louisiana,* the state statute "interfere[d] with the FERC's authority to regulate the determination of the proper allocation of costs associated with the sale of natural gas to consumers." 451 U.S. at 749.

462 U.S. at 185.

vividly that the Commission continues to exercise its statutory responsibilities of pipeline regulation. These proceedings, most notably the Commission's pending investigation of the purchasing practices of Appellant, Transco, are likely to conflict directly with state ratable take orders.

In Opinion Nos. 204 and 204-A, *Columbia Gas Transmission Corporation*, Docket Nos. TA81-1-21, *et al.*, 26 FERC ¶ 61,034 (January 16, 1984) and 26 FERC ¶ 61,334 (March 16, 1984), *appeal docketed, Office of the Consumers' Counsel, State of Ohio v. FERC*, No. 84-1099 *et al.* (D.C. Cir.), the Commission recently reaffirmed its commitment to regulating interstate gas pipelines. These proceedings involved an investigation of the purchasing practices of Columbia Gas Transmission Corporation (Columbia) under both the NGPA Section 601(c)(2) "fraud or abuse" standard and the more expansive NGA Sections 4 and 5 "just and reasonable" standard, commonly referred to as a standard of prudence.[5] As a preliminary issue, the Commission affirmed the determination of the Administrative Law Judge (ALJ) that the NGPA " 'does not remove the Commission's authority to examine contracts and practices and provide for appropriate relief when such contracts or practices are found to be unjust, unreasonable, unduly discriminatory or preferential.' " 26 FERC at 61,096. The Commission then concluded, *inter alia*, that "Columbia's gas acquisition

---

[5] Prior to the NGPA's passage, a pipeline's ability to pass through the cost of gas to its distributor-customers was a function of the Commission's determination of the justness and reasonableness of the proposed rates. Because the NGPA replaced the Commission's authority to determine wellhead prices as to certain gas with statutory "maximum lawful prices," the Commission was directed to deny passthrough of the wellhead cost of gas only where it "determines that the amount paid [by the pipeline] was excessive due to fraud, abuse or similar grounds." 15 U.S.C. § 3431(c)(2). The other aspects of a pipeline's purchasing practices remain subject to the prudence standard.

practises are imprudent and unjust and unreasonable under NGA Section 5." 26 FERC at 61,112. Specifically with regard to the take or pay provisions in Columbia's gas supply contracts, the Commission found that, "while the take or pay provisions were not unreasonable when entered into, the effect of these provisions under present conditions is unjust, unreasonable, unduly discriminatory and preferential." *Id.* at 61,120. The Commission explained that the pipeline's take or pay situation

> is harmful to Columbia's customers who stand to lose markets because of fuel switching and unfair to consumers who must bear the cost. It is discriminatory to low-cost producers whose production is cut back. It is potentially harmful to Columbia itself.

Id. It is evident, from this example of the FERC's exercise of its NGA authority, that a pipeline's purchases in conformity with state ratable take schemes—potentially resulting in increased costs for the pipeline and its customers—could very well be deemed imprudent under federal standards and, therefore, unlawful.

While the FERC is currently conducting a series of inquiries into the purchasing practices of various interstate pipelines,[6] the most obvious—and imminent—possi-

---

[6] *See Panhandle Eastern Pipe Line Company*, Docket No. TA84-1-28-002, Order Establishing Hearing Procedures, 26 FERC ¶ 61,339 (March 16, 1984); *El Paso Natural Gas Company*, Docket No. RP82-33 *et al.*, Order on Rehearing Modifying Prior Orders, Consolidating Cases, and Setting Hearing, 26 FERC ¶ 61,366 (March 21, 1984); *MIGC, Inc.*, Docket No. RP84-15-000, Order Accepting Filing, Consolidating Proceedings and Setting Matters for Hearing, 26 FERC ¶ 61,369 (March 21, 1984); *Trunkline Gas Company*, Docket No. TA83-1-30-002 *et al.*, Order Setting Matter for Hearing and Consolidating Proceedings, 26 FERC ¶ 61,363 (March 21, 1984); *Southern Natural Gas Company*, Docket No. TA84-1-7-000 *et al.*, Order Consolidating Proceedings and Setting Matters for Hearing, 26 FERC ¶ 61,371 (March 21, 1984); *Transcontinental Gas Pipe Line Corp.*, Docket No. TA83-2-29-001 *et al.*, Order Estab-

bility of collision with Mississippi's enforcement of its ratable take order involves the pending FERC investigation into the purchasing practices of Appellant, Transco.

On September 28, 1984, Transco initiated a Purchased Gas Adjustment proceeding at the Commission seeking, among other things, an increase in rates filed in its FERC Gas Tariff. *Transcontinental Gas Pipe Line Corporation*, Docket Nos. TA85-1-29-000 and TA85-1-29-001. On October 12, 1984, AGD filed a Motion to Intervene and Protest in this proceeding, asserting that Transco has not demonstrated the justness and reasonableness of its proposed rate increase. AGD also raised several important issues with regard to the purchasing practices of Transco. Specifically, AGD's motion stated that:

> AGD is aware that certain of Transco's gas supply agreements contain high percentage take-or-pay provisions substantially identical to those contracts found "unjust and unreasonable" by the Commission's Opinion No. 204. AGD is particularly interested in the manner in which higher-priced contracts with high percentage take-or-pay provisions have affected, and will continue to affect, Transco's purchasing practices and cost of gas supply. Similarly, AGD is aware that Transco's November 1984-April 1985 purchase pattern will be influenced by a ruling of the Mississippi Oil & Gas Board in which Transco is required

---

lishing Hearing Procedures on Deferred Purchasing Practices Issues, 26 FERC ¶ 61,361 (March 21, 1984).

While no pending case has been found to illustrate the point, it is also possible that FERC action pursuant to Section 7 of the NGA could create a collision with a state ratable take statute such as the one at bar. FERC's general jurisdiction to regulate the transportation of natural gas in interstate commerce (NGA Section 1) is accompanied by the power to *condition* certificates (issued under NGA Section 7) authorizing interstate pipelines to construct and operate gas transportation facilities. *See Maryland People's Counsel v. FERC*, No. 84-1090, slip op. at 20 n.19 (D.C. Cir. May 10, 1985).

> to accept deliveries on a "ratable take" basis from certain Mississippi supply sources. It is not clear that this pattern of Mississippi purchases satisfies the just and reasonable standard applicable to Transco's purchase pattern under Sections 4 and 5 of the Natural Gas Act nor is it clear that pro rata purchases of decontrolled wellhead purchases are consistent with the lowest reasonable cost standard.

Motion of AGD to Intervene and Protest at 7.

In its "Order Accepting and Suspending Proposed Tariff Sheets Subject to Refund and Conditions," issued in the Transco PGA proceeding, 29 FERC ¶ 61,148 (October 31, 1984), the Commission responded to AGD's concerns by ordering a public hearing "concerning the lawfulness of Transco's proposed rates, *including purchasing practices issues.*" *Id.* at 61,321-22 (emphasis added). This order was clarified in its "Order Accepting and Suspending Proposed Tariff Sheets Subject to Refund and Conditions, Setting Matters for Hearing, and Consolidating Dockets," 31 FERC ¶ 61,129 (April 30, 1984), where the Commission explicitly acknowledged AGD's arguments. It stated that the "purchasing practices" issues set for hearing included the allegations that "Transco's prospective purchasing patterns may be adversely influenced by 'ratable take' orders of the Mississippi Oil and Gas Board" and that "certain court orders pertaining to the rights of producers may be thwarting a least cost purchasing strategy and are in violation of [the FERC's] 'exclusive jurisdiction' over purchases of gas by Transco." *Id.* at ——, mimeo at 8-9.

If, after the public hearing and investigation, the Commission finds that Transco's compliance with the Mississippi ratable take order is unjust and unreasonable,[7] the

---

[7] It is conceivable that the FERC will rule that Transco's purchases of Mississippi gas were inconsistent with its duty to acquire gas at the lowest reasonable cost and that its purchase pattern should be adjusted to exclude some portion of the Mississippi pro-

pipeline will be in the position of necessarily violating either state or federal law. The FERC would have authority, furthermore, under NGA Sections 4 and 5 to order Transco to adhere in the future to a pattern of gas acquisition which is inconsistent with the state ratable take scheme. As this Court reiterated in the post-NGPA *Maryland v. Louisiana* case, "[t]he FERC need not adjust its ruling to accommodate" the state statute. 451 U.S. at 725. Moreover, the case law clearly directs that in a situation of actual federal-state conflict, where "compliance with both federal and state regulations is a physical impossibility," the Supremacy Clause requires the state law to fall to the federal law. *Pacific Gas and Electric Company v. State Energy Resources Conservation and Development Commission*, 461 U.S. 190, 204 (1983), citing *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963).

Importantly, the doctrine of federal preemption does not apply only in cases of actual conflict between state and federal law. The attempted state regulation must fall in a situation where, "[a]t the very least, there is an imminent possibility of collision." *Maryland v. Louisiana*, 451 U.S. at 725, citing *Northern Natural*, 372 U.S. at 92. Given the "imminent possibility" of a FERC order directing Transco to correct its purchasing practices in a manner inconsistent with the Mississippi ratable take scheme, this state regulation is preempted.

---

duction required to be taken under that State's Oil & Gas Board's order. *See Columbia Gas Transmission Corp., supra*, where the Commission resolved to "take action to ensure that Columbia corrects its gas acquisition practices." 26 FERC at 61,112.

II. THE REGULATION OF INTERSTATE PIPELINES IS PARTICULARLY LIKELY TO AFFECT NATIONAL ENERGY INTERESTS, AND THEREFORE REQUIRES A UNIFORM, COMPREHENSIVE SCHEME OF FEDERAL REGULATION.

A. State By State Regulation Of Pipeline Purchasing Practices Will Impose Substantial Burdens Upon The Interstate Gas Market.

A system of divergent, perhaps conflicting state regulations of pipeline purchasing practices would place enormous burdens on all segments of the interstate gas market. State "ratable take" regulation, therefore, stands "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941), evidenced in its enactment of a comprehensive federal statutory scheme, under both the NGA and the NGPA, for the regulation of interstate gas pipelines.

The Mississippi Supreme Court's statement that the "only burden" created by Statewide Rule 48 is a burden upon Transco and not pipelines generally, as well as the entire interstate market for natural gas, 457 So.2d at 1323, is a gross understatement. Even discounting the increased gas costs incurred through take or pay exposure in Transco's contracts, the fact remains that Transco and all other interstate pipelines which purchase gas in Mississippi are burdened with the responsibility of altering their purchasing patterns to comply with the ratable take order. These pipelines henceforth must take their gas supplies ratably from every producer who owns an interest in a "common source of supply." In some cases, this could result in forced purchases from large numbers of non-contracting parties.[8]

---

[8] The Mississippi court itself admitted concern about the fact that it did not know exactly how many wells (in addition to the six named) were producing from the Harper Sand Gas Pool. Lacking this information, the court stated that "[s]hould there be other

This administrative burden is one of potentially enormous proportions. Quite apart from Mississippi, major gas producing states such as Louisiana and Texas have ratable take statutes which could become enforceable against interstate pipeline companies. If the Mississippi law is upheld here, compliance with several state ratable take statutes—each having important *differences*—may in fact be an impossibility. For example, the Texas ratable take statute provides that a pipeline "common purchaser" must take gas "without discrimination in favor of one producer or person against another producer or person in the same field and *without unjust or unreasonable discrimination between fields in this state.*" TEX. NAT. RES. CODE ANN. §§ 111.083, 111.086 (Vernon 1978). (Emphasis added).[9] Under the Mississippi court's rationale, even the Kansas ratable take statute invalidated by this Court in *Northern Natural* would have to be upheld today as applied to first sales of NGPA deregulated gas. That statute forced pipelines to take ratably on a statewide basis.[10] As the Court

---

producers or owners . . . they will have to make that fact known to the appropriate tribunal before they may be afforded any relief." 457 So.2d at 1327 n.13.

[9] *See also* OKLA. STAT. ANN. tit. 52, § 823 (West 1969):

> [every pipeline which is engaged in the business of purchasing natural gas] shall purchase all the natural gas in the vicinity of, or which may be reasonably reached by its pipe lines, or gathering branches, without discrimination in favor of one producer or one person as against another, . . .

LA. REV. STAT. ANN. § 30:42 (West 1975):

> every person engaged in the business of purchasing and selling natural gas in this state . . . shall purchase all of the natural gas which may be offered for sale which may be brought in pipes and connecting lines . . . without discrimination in favor of one producer against another, or in favor of any one source of supply as against another save as authorized by the commissioner. . . . If a person is unable to purchase all the gas offered, then he shall purchase natural gas from each producer ratably . . .

[10] *See* 372 U.S. at 88.

noted in *Northern Natural*, these orders "shift to the shoulders of interstate purchasers the burden of performing the complex task of balancing the output of thousands of natural gas wells within the state . . . a task which would otherwise presumably be the State Commission's." 372 U.S. at 92. The implementation of diverse state regulations such as these would impose tremendous administrative burdens on all pipelines forced to comply with them while at the same time satisfying their responsibilities under federal regulation. The resultant costs, of course, would ultimately fall upon consumers.

Complex and conflicting state by state regulation of pipeline purchasing practices, furthermore, would put impossible burdens on the FERC's ability to carry out its regulatory mandate. In a closely analogous case, this Court struck down a local airport anti-noise ordinance on federal preemption grounds. The Court noted, *inter alia*, that if other localities followed with ordinances of their own, "it is obvious that fractionalized control of the timing of take-offs and landings would severely limit the flexibility of the FAA in controlling air flow." *Burbank v. Lockheed Air Terminal*, 411 U.S. 624, 639 (1973). Likewise, with conflicting state demands on a pipeline's gas acquisition practices, the Commission would be unable to undertake any meaningful supervision of pipeline purchasing practices, as it is statutorily bound to do.

B. The Growth Of Divergent State Regulation Of Pipeline Purchasing Practices Will Have Unjust And Oppressive Consequences For The Nation's Gas Consumers.

As mandated by the Natural Gas Act, the fundamental responsibility of the FERC is to protect the nation's gas consuming public against excessive rates and charges and to set policies which provide natural gas "at the lowest reasonable rate consistent with the maintenance of adequate service." *Atlantic Refining Co. v. Public Service Commission of New York*, 360 U.S. 378, 388 (1959). *See generally, Maryland v. Louisiana, supra*, 451 U.S. at

747-48, *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 610-12 (1944). This protection is exactly what would be lost if the states were permitted to enter individually into the field of interstate pipeline regulation.

The Mississippi Supreme Court itself recognized the problem for consumers and described it thus:

> Transco has the right to pass the costs it incurs in purchasing natural gas through to the consumer. 15 U.S.C. § 3431(c). In this sense, it is not Transco who experiences a burden, it is the consumer. If higher purchasing prices at the wellhead lead to higher prices to the consumer and a loss of markets, this is simply one inevitable consequence of the free market policies of the era of deregulation with respect to which Transco is vested by the negative Commerce Clause with no right to complain.

Transcontinental Gas Pipe Line Corporation, 457 So.2d at 1322. What the court neglected to address, however, is the absence of any recourse to out-of-state consumers burdened with the additional costs resulting from state ratable take orders. It is well settled that state regulatory agencies such as the Mississippi Oil & Gas Board are "obliged to regulate in the State, not the national interest." *FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 633 (1972). As appellant noted in its Jurisdictional Statement, the Mississippi Oil & Gas Board expressly refused to consider evidence submitted on the interstate impact of its action. J.S. at 17. Furthermore, this Court has acknowledged the "unavoidable conflict between producing States and consuming States." *Louisiana Power & Light*, 406 U.S. at 633-34. *See also Public Service Commission of Kentucky v. FERC*, 610 F.2d 439, 443 (6th Cir. 1979). *See generally, Pennsylvania v. West Virginia*, 262 U.S. 553 (1922). Thus, the states can not and will not consider national needs in their regulation of interstate gas pipelines.

This Court stated recently that

> the production and transmission of energy is an activity particularly likely to affect more than one State, and its effect on interstate commerce is often significant enough that uncontrolled regulation by States can patently interfere with broader national interests.

Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission, 461 U.S. 375, 377 (1983). With the continued market dominance of interstate pipelines, *see Maryland People's Counsel v. FERC*, No. 84-1090, slip op. at 13-17 (D.C. Cir. May 10, 1985), and the continued need for federal protection of consumers against unfair and excessive rates, the federal interest is clear. It must be assumed to preclude enforcement of state laws regulating the same activity that Congress made the subject of federal regulation.

CONCLUSION

For the foregoing reasons, AGD respectfully requests this Court to reverse the decision below of the Mississippi Supreme Court, and find that the State of Mississippi's attempt to regulate the purchasing practices of an interstate natural gas pipeline is a violation of the doctrine of federal preemption under the Supremacy Clause of the Constitution.

Respectfully submitted,

FREDERICK MORING
Counsel of Record

M. LISANNE CROWLEY
CROWELL & MORING
1100 Connecticut Ave., N.W.
Washington, D.C. 20036
(202) 452-5800

Attorneys for Amicus Curiae Associated Gas Distributors

May 30, 1985

Office-Supreme Court, U.S.
FILED
JUL 18 1985
ALEXANDER L. STEVAS,
CLERK

NO. 84-1076

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPELINE CORPORATION,
Appellant

V.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI
AND
COASTAL EXPLORATION, INC., et al.,
Appellees

ON APPEAL FROM THE SUPREME COURT
OF MISSISSIPPI

BRIEF FOR THE STATE OF TEXAS AS AMICUS CURIAE

JIM MATTOX
Attorney General of Texas

DAVID R. RICHARDS
Executive Assistant Attorney General

LARRY J. LAURENT
Assistant Attorney General
Chief, Energy Division

MANUEL RIOS*
Assistant Attorney General
P.O. Box 12548, Capitol Station
Austin, Texas 78711-2548

Attorneys for
The State of Texas

*Counsel of Record

BEST AVAILABLE COPY

QUESTIONS PRESENTED

1. The Preemption Question: Are State ratable-take orders for deregulated "deep high-cost natural gas" under §107 of the Natural Gas Policy Act of 1978 (NGPA) preempted by federal authority?

2. The Commerce Clause Question: Does the ratable take order of the Mississippi Oil and Gas Board violate the Commerce Clause of the United States Constitution?

TABLE OF CONTENTS

PAGE

Table of Authorities iii

Interest of Amicus Curiae, The State of Texas iii

Summary of Argument 1

Argument:

I. State Ratable—Take Orders for Section 107 Gas Sold in Interstate Commerce Are Not Preempted by Federal Authority 2

A. The Passage of the NGPA Renders This Court's Decision in *Northern Natural* not Applicable to the Fact Situation in the Present Case 3

B. The NGPA Does not Preempt State Orders Requiring Interstate Pipelines to Ratably Take Deregulated Gas 5

C. The Deregulation of "High Cost" Gas Does Not Prohibit State Orders to Take Ratably 8

D. State Orders, Like Those Issued by the Railroad Commission of Texas, That Require Interstate Pipelines to Take Ratable are Conservation Measures and Serve the Ends of Federal Law 8

II. The Commerce Clause Question Should be the Controlling Issue in This Case 11

Conclusion 12

TABLE OF AUTHORITIES

CASES	PAGE
Arkansas Electric Cooperative Corp. v. Arkansas Public Commission, 103 S. Ct. 1095 (1983)	8
Brown v. Humble Oil & Refining Co., 126 Tex. 296, 83 S.W.2d 934 (1935)	9
Cities Service Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179 (1950)	3,8,11,12
Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981)	5
DeCanas v. Bica, 424 U.S. 351 (1976)	5
Exxon Corp. v. Eagerton, 103 S. Ct. 2296 (1983)	5
Exxon Corp. v. Maryland, 437 U.S. 117 (1978)	5
Florida Lime and Avocado Growers, Inc. v. Paul, 373 U.S. 132 (1963)	5
FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944)	6
Northern Natural Gas Co. v. State Corporation of Kansas, 372 U.S. 84, reh'g denied, 372 U.S. 1011 (1963)	2,4,6,12
Ohio Oil Co. v. State of Indiana, 177 U.S. 190 (1900)	11
Pacific Gas and Electric Co. v. State Energy Resources Conservation & Development Commission, 103 S. Ct. 1713 (1983)	5,11
Palmer v. Massachusetts, 308 U.S. 70 (1939)	5

Railroad Commission v. Aluminum Co. of American, 380 S.W. 2d 599 (Tex. 1964) 11

Railroad Commission v. Mackhank Petroleum Co., 144 Tex. 393, 190 S.W. 2d 802 (1945) 10

Railroad Commission v. Shell Oil Co., 380 S.W. 2d 556 (Tex. 1964) 9

Schwartz v. Texas, 344 U.S. 199 (1952) 5

Texaco, Inc. v. Railroad Commission, 583 S.W. 2d 307 (Tex. 1979) 9,10

STATUTORY PROVISIONS

15 U.S.C. §717(b) (1976) 4
15 U.S.C. §717(c) (1976) 6
15 U.S.C. §717c(e) (1976) 4
15 U.S.C. §717f(b) (1976) 4
15 U.S.C. §717f(c) (1976 & Supp. 1985) 4
15 U.S.C. §3317(a) (1982) 2,4
15 U.S.C. §3331(b) (1982) 4
15 U.S.C. §3431(a) (1982) 4
15 U.S.C. §3431(a)(1) (1982) 4
15 U.S.C. §3431(a)(1)(B)(i) (1982) 4
15 U.S.C. §3431(c)(2) (1982) 7

TEXAS CONSTITUTIONAL AND STATUTORY PROVISIONS

TEX. CONST. art. XVI, §59(a) 9
TEX. NAT. RES. CODE ANN. § 85.046(9) (Vernon 1978 & Supp. 1984) 10
TEX. NAT. RES. CODE ANN. §§85.121-.125 (Vernon 1978 & Supp. 1984) 10
TEX. NAT. RES. CODE ANN. §85.123 (Vernon 1978) . 10
TEX. NAT. RES. CODE ANN. §85.201 (Vernon 1978) .. 9
TEX. NAT. RES. CODE ANN. §85.202 (b) (Vernon 1978) 9
TEX. NAT. RES. CODE ANN. §86.012(b) (Vernon 1978 & Supp. 1984) 10

16 TEX. ADMIN. CODE §§3.28, 3.29, 3.30, 3.31, & 3.91 (Dec. 1982) 9

OTHER AUTHORITY

Note, *Natural Gas Regulation and vested Property Interest: Ratable Taking, Proration Standards and Fieldwide Civil Liability,* 62 TEX. REV. 691 (1983) 7

Pierce, *Natural Gas Regulation, Deregulation & Contracts,* 68 VA 63, 67 n. 18 (1982) 6

NO. 84-1076

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPELINE CORPORATION,
Appellant

V.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI
AND
COASTAL EXPLORATION, INC., et al.,
Appellees

ON APPEAL FROM THE SUPREME COURT
OF MISSISSIPPI

BRIEF FOR THE STATE OF TEXAS AS AMICUS CURIAE

INTEREST OF AMICUS CURIAE

The State of Texas is the site of approximately one third of all the oil and gas production in the United States. The Railroad Commission of Texas is the State agency that regulates this production. The Railroad Commission's regulatory scheme for the conservation of oil and gas is complex and has been generations in the making. An essential and necessary part of this scheme of regulation is the ability of the Railroad Commission to require that interstate and intrastate natural gas pipelines take ratably from all the wells in the fields that they serve.

It is in the best interest of the State of Texas and the United States that the Texas regulatory system for the conservation of oil and gas not be weakened. A decision in this case that States cannot require interstate pipelines to take "high cost"

deregulated gas in a ratable manner will seriously damage the Texas conservation system. Such a decision will result in the waste of natural gas.

SUMMARY OF THE ARGUMENT

1. Peemption

Section 107 of the National Gas Policy Act of 1978 (NGPA) deregulates "high cost" gas produced from wells deeper than fifteen thousand feet. 15 U.S.C. §3317(a) (1982). All the natural gas in this case is "high cost" gas under §107 of the NGPA. The Federal Energy Regulatory Commission (FERC) no longer has certificate or abandonment power over the gas in this particular case. Section 107 gas is subject neither to NGPA regulatory controls nor an NGPA price ceiling.

Since FERC no longer has statutory authority to regulate the first sale of §107 gas, this Court's decision in *Northern Natural Gas Co. v. State Corporation Commission of Kansas,* 372 U.S. 84 (1963) does not apply to the present case. The decision in *Northern Natural,* which voided a state ratable take order, was made under the unique facts of the Natural Gas Act of 1938 (NGA). Under the NGA, the Federal Power Commission (now FERC) had exclusive regulatory jurisdiction over an interstate pipelines purchase of natural gas. The NGPA eliminated FERC's regulatory authority over first sales of "high cost" natural gas. The NGPA is a deliberate departure from the "pervasive scheme" of federal regulation that was the basis for the *Northern Natural* decision.

Orders, like those issued by the Railroad Commission of Texas, directing interstate pipelines to take §107 gas in a ratable manner are a vital and necessary part of the Texas conservation system. The locations within a field from which oil and gas is drawn from the ground can increase or decrease recovery. There are certain types of oil wells that will be destroyed if they are ever shut in. If the decision to take the gas from some wells in the field are not made on the basis of sound engineering, but instead are made on the basis of which producers will submit to the contract terms imposed by the pipeline company, then waste will result. Furthermore, if the

owners of oil wells are not allowed access to a pipeline for the transportation of the gas produced in association with their oil, they may attempt to continue producing the oil and flare or vent the gas. This too is a waste of hydrocarbons.

The State of Texas is concerned that in deciding the preemption and Commerce Clause issues this Court will review ratable take orders as actions designed only to protect correlative rights. It is important that this Court understand that ratable take orders are an essential part of the Texas conservation system. A decision that disregards this fact could have devastating consequences on the State's efforts to prevent the waste of oil and gas. Such a decision would be in conflict with the federal policies announced in such statutes as the NGPA and the Connally Act. The greater deference that this Court gives to an exercise of State police powers to promote conservation is required by the facts of this case.

2. Commerce Clause.

The State of Texas believes the preemption question in this docket is eliminated by the changes in federal law wrought by the passage of the NGPA. The Commerce Clause question therefore should be the controlling issue in this case. In *Cities Service Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179 (1950), this Court upheld the Oklahoma Common Purchaser Act against a Commerce Clause challenge. This latter statute is similar to the Texas Common Purchaser statute that authorizes the Railroad Commission to issue orders requiring ratable taking. The State of Texas therefore believes that the decisive issue in this case is whether the unique characteristics of the Mississippi scheme of ratable take do or do not violate the Commerce Clause. This honorable Court should hold that the Mississippi ratable take order is not a burden on interstate commerce.

ARGUMENT

I. STATE "RATABLE-TAKE" ORDER FOR SECTION 107 GAS SOLD IN INTERSTATE COMMERCE ARE NOT PREEMPTED BY FEDERAL AUTHORITY

A. The Passage of the NGPA Renders this Court's Decision in *Northern Natural* not Applicable to the Fact Situation in the Present Case

All gas production from the Mississippi fields in the present case was from wells deeper than 15,000 feet and is thus "high cost gas" under §107 of the NGPA. This type of gas is expressly deregulated by statute. 15 U.S.C. §3317(a) (1982). The FERC's jurisdiction over this type of gas, which was found in the NGA, 15 U.S.C. 717(b) (1976), was eliminated by the NGPA. 15 U.S.C. §3431(a)(1) (1982). The FERC has neither certificate nor abandonment power over §107 gas.[1] Section 107 gas is subject neither to NGPA regulatory controls nor an NGPA price ceiling. 15 U.S.C. §§3331(b) (1982), 3431(a)(1)(B)(i).

The FERC argues that, contrary to the view of the courts below, Section 601(a) of the NGPA, 15 U.S.C. §3431(a) (1982), did not undermine *Northern Natural*, or the principles there articulated. (Brief for the U.S. and FERC, p. 11). In *Northern Natural*, this Court invalidated an order of the Kansas State Commission because the NGA has conferred exclusive jurisdiction over the sale and transportation of natural gas in interstate commerce to the FPC (now FERC). *Northern Natural*, 372 U.S. at 92.

As discussed above, FERC no longer has jurisdiction over §107 "high cost" gas. The State of Texas believes that the statutory basis for voiding the state order in *Northern Natural* was shattered by the NGPA and its accompanying deregulation. As a result, the NGA analysis in *Northern Natural* is not applicable to deregulated "high cost" gas under §107 of the NGPA.

---

1. Under the NGA system, a natural gas producer seeking to contract for the interstate sale of gas must apply to the FERC for a certificate of public convenience and necessity authorizing the sale. 15 U.S.C. §717f(c) (1976 & Supp. I 1985). After the certificate is issued the producer must continue to supply the gas to the purchaser and cannot abandon the service without the Commission's express prior approval. 15 U.S.C. §717f(b) (1976). Furthermore, the burden of proof is placed on the pipeline to show the rates being charged are "just and reasonable." 15 U.S.C. §717c(e) (1976).

B. The NGPA Does Not Preempt State Orders Requiring Interstate Pipelines to Ratably Take Deregulate Gas.

Since the NGA is no longer applicable to what is now classified as §107 gas, it is the NGPA that must be examined to determine if the ratable take order of the Mississippi Oil and Gas Board is preempted. A review of this latter statute reveals that there is no express preemption provision in the NGPA. *Exxon Corp. v. Eagerton*, 103 S. Ct. 2296, 2304 (1983).

When construing legislation, this Court "[h]as disfavored inroads by implication on state authority..." *Palmer v. Massachusetts*, 308 U.S. 70, 84 (1939). Only a demonstration that the complete ouster of state power was the clear and manifest purpose of Congress warrants the preemption of state regulatory authority. *DeCanas v. Bica*, 424 U.S. 351, 357 (1976). The conclusion that Congress legislated the ouster of a state statute cannot be made, "[i]n the absence of an unambiguous congressional mandate to that effect." *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 146-47 (1963). Congressional intent to supersede the exercise of power by the state is not assumed unless there is a clear manifestation of intention to do so. *Schwartz v. Texas*, 344 U.S. 199, 202-03 (1952).

In addition, general statement by Congress of national policy do not indicate an intent to preempt all state legislation in the area affected. This rule even applies to state legislation that may have an adverse impact on the announced federal policy. *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 633 (1981); *Exxon Corp. v. Maryland*, 437 U.S. 117, 133-34 (1978).

Implied preemption can be inferred from a "scheme of federal regulation so pervasive" that "the federal system will be assumed to preclude enforcement of state laws on the same subject." *Pacific Gas and Electric v. State Energy Resources Conservation & Development Commission*, 103 S. Ct. 1713, 1722 (1983). Unlike the NGA, the NGPA does not create a pervasive system of federal regulation. It was the failure of the exclusively federal system of the NGA that led to the creation of the NGPA.

The system of regulation created by the NGPA and overseen by the FERC caused severe market distortions. Low FERC-set prices encouraged producers to forego the interstate market and to enter the more lucrative intrastate market, the latter being exempt from NGA and federal controls. 15 U.S.C. §717(c) (1976). The decline in interstate reserves in the late 1960's was the first indication of an impending gas shortage. Gas demand began to outstrip the discovery of new gas. As result of the lag between declining reserves and inadequate deliverability, the shortage first affected end-use consumers in 1971, when curtailments, or rationing commenced. Pierce, *Natural Gas Regulation, Deregulation, and Contracts,* 68 VA. L. REV. 63, 67 n. 18 (1982).

The primary purpose of the NGA was to protect consumers against exploitation at the hands of natural gas companies. *FPC v. Hope Natural Gas Co.,* 320 U.S. at 611. The heart of this system was the pervasive federal regulatory scheme for the setting of "just and reasonable" rates for all natural gas in interstate commerce. *Id.* at 612. The aim of the NGPA is different. It is to protect consumers by ensuing sufficient gas supplies while at the same time maintaining enough controls to prevent the rapid increases in price that might result from full deregulation.

In its preemption argument, the FERC ignores the changes in Federal policy and law that were made by the passage of the NGPA. The FERC argues that under the NGPA its authority is the same as under the NGA and that it still possesses the power to regulate the "intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States." *Northern Natural,* 372 U.S. at 92 (Brief for the U.S. and FERC. pp. 17-18). Contrary to FERC's position, Congress drastically diminished the role of the FERC in overseeing the price of natural gas moving in interstate commerce. The NGPA expressly eliminated FERC jurisdiction over the first sale of certain types of natural gas, including the deregulated gas at issue in this case.

The FERC also argues that State ratable take orders are preempted because they conflict with the FERC's authority

under 15 U.S.C. §3431(c)(2)(B)(1982) to ensure that a pipeline's pass through of its gas costs is consistent with the rules implementing the incremental pricing provisions of the NGPA. (Brief for the U.S. and FERC. pp. 22-23). Incremental pricing was intended to shift some of the icnreased costs of the partially increased deregulated gas market to industrial users. It was also intended to curb the bidding up of prices on deregulated gas supplies. The FERC offers the following analysis:

> Accordingly an integral part of the incremental pricing system established by Title II of the NGPA is its reliance on market forces to control the wellhead price of high cost gas. The state ratable take rule substitutes state regulation of the free market necessary to make the incremental pricing provision operate as Congress intended.

(Brief for the U.S. and FERC, p. 24)

The Texas system of ratable take does not interface with the free market. Ratable take orders issued by the Texas Railroad Commission do not force interstate pipelines to purchase more Texas natural gas than the pipelines desire nor do such orders attempt to force additional "high cost" gas into interstate commerce. The Texas sytem is, therefore, not in conflict with the FERC's incremental pricing authority.[2]

Indeed the FERC itself cites with approval the statement that state regulatory orders enforcing ratable production in a field at market demand levels (i.e., true market demand proration orders) cannot be manipulated for purposes of economic protectionism. (Brief of the U.S. and FERC, p. 15 n. 13) (citing, Note, *Natural Gas Regulation and Vested Property Interest: Ratable Taking, Proration Standards and Fieldwide Civil Liability,* 62 TEX. L. REV. 691, 722-23 (1983)).

---

2. The State of Texas respectfully refers this Court to the discussion in Coastal Exploration Inc.'s Motion to Dismiss or, In the Alternative, to Affirm the Decision of the Supreme Court of Mississippi, pp. 6-7, regarding the lack of conditions which the Mississippi Oil and Gas Board ratable take order placed on Transcontinental Gas Pipeline Corporation.

Congress replaced the federal scheme of well-head-to-city-gate FERC regulation by a general statutory pattern of well-head prices; it declared much of the remaining FERC interpretive and enforcement authority to be delegatable to state commission; and it consciously ceded to the States a measure of direct control over intrastate well head prices. These are not the characteristics of a federal system that is so pervasive as to warrant a finding the Congress intended to preempt State regulation by implication. This is especially true when the State action is not an attempt at economic regulation but is a valid use of the State's traditional police powers to prevent the waste of natural gas.

C. The Deregulation of "High Cost" Gas Does Not Prohibit State Orders to Take Ratably

In its brief, the FERC cites *Arkansas Electric Cooperative Corp. v. Arkansas Public Commission,* 461 U.S. at 384, for the proposition that the federal decision to forego regulation in an area implies a federal determination that the area be left unregulated and preempts state regulation. (Brief for the U.S. and FERC, pp. 13-14) This form of federal preemption was not intended by the NGPA's deregulation. Congress did not state that wellhead prices of "high cost" gas should be left unregulated by the States. Nor does a review of the NGPA evidence any attempt by Congress to ban ratable take orders.

Ratable take orders to interstate pipelines, like the orders issued by the Railroad Commission of Texas ratable take orders prevent the waste of natural gas and thus protect consumers by requiring the recovery of natural gas in the most efficient manner. This ensures large supplies of gas for consumers. Preemption should not be implied in this instance because, "Insofar as conservation is concerned, the national interest and the interest of producing states may well tend to coincide." *Peerless,* 340 U.S. at 188.

D. State Orders, Like those Issued by the Railroad Commission of Texas, That Require Interstate Pipelines to Take Ratably are Conservation Measures and Serve the Ends of Federal Law

Both the Texas Constitution and the statutes of the State place a mandatory duty on the Railroad Commission of Texas to prevent the waster of oil and gas.[3] The authority to require pipelines to take gas in a ratable manner from all the wells in a gas field is therefore a vital part of the Texas conservation system.[4] If a well owner is denied the right of access to a natural gas pipeline and has to shut in his wells, valuable oil and gas will be drained from beneath his lease. These hydrocarbons will enrich neighbors whose wells have connections to the pipeline. In such a situation, well owners without connections to a pipeline may try to produce the oil and illegally vent or flare the gas.

---

3. In 1917, the people of the State of Texas adopted TEX. CONST. art. XVI, §59(a). This constitutional provision makes the conservation of all natural resources a public right and duty. The Texas Supreme Court held that Article XVI, §59(a) "[d]irects the Legislature to do whatever is necessary for the conservation of natural resources." *Brown v. Humble Oil & Refining Co.*, 126 Tex. 296, 83 S.W. 2d 935, 941 (1935). To comply with the mandate of the Constitution, the Texas Legislature requires that the Railroad Commission "[m]ake and enforce rules and orders for the conservation of oil and gas." TEX. NAT. RES. CODE ANN. §85.201 (Vernon 1978), and, "[d]o *all things necessary* for the conservation of oil and gas and prevention of waster of oil and gas and may adopt other rules and orders *as may be necessary* for those purposes." TEX. NAT. RES. CODE ANN. §85.202(b) (Vernon 1978) (emphasis added). These statutes impose a mandatory duty of the Commission to prevent the waster of oil and gas. *Texaco, Inc. v. Railroad Commission*, 583 S.W. 2d 207, 310 (Tex. 1979); *Railroad Commission v. Shell Oil Co.*, 380 S.W. 2d 556, 559 (Tex. 1964).

4. The legal framework of the Railroad Commission's natural gas propration system is provided by Chapter 85 of the Texas Natural Resources Code, the Oil and Gas Division Statewide Rules 28, 29, 30, and 31, and the Gas Market Demand Rule (16 TAC §§3.28, 3.29, 3.30, 3.31, and 3.91) (Dec. 1982). Chapter 86 of the Natural Resources Code gives the Commission the authority to prorate and regulate daily gas well production to prevent waster and adjust the correlative rights and opportunities of owners of gas to produce and use or sell their gas.

The Texas proration system is an effort to distribute the market demand for gas fairly among various producers in a way that reflects the actual ownership of gas in the reservoir. The production of gas that is allowed by the Commission in any given month is closely tied to the anticipated market demand for the month. The conservation statutes contained in Chapter 85 of the Texas Natural Resources Code give the Railroad Commission the authority to determine the market demand for gas and set the allowable production.

Further, if a reservoir is drained of its natural gas solely on the basis of contract rights then the decision on how the reservoirs should be drained will be made not on sound engineering principles but on the basis of which producers in the field are willing to meet the contracts demands of the pipeline.

There are also certain types of wells that will be destroyed if they are shut in. Oil wells that are capable of flowing on their own, but which have marginal bottom hole pressure, fall within this category. See Marginal Wells, TEX. NAT. RES. CODE ANN. §§85.121-125 (Vernon 1978, Supp. 1984). In these wells, the bottom hole pressure is capable of lifting the fluid and gas in the well column to the surface. If these wells are shut in, the reservoir continues to push fluids into the column so that after a while the marginal bottom hole pressure cannot push the fluids and gas to the top. Oftentimes these marginal wells do not produce enough hydrocarbons to pay for using an artificial lift on the well. The Railroad Commission adjusts its allowables to try to prevent the destruction of such wells. It will order that they continue to flow even when it shuts in an entire field. *Railroad Commission v. Mackhnak Petroleum Co.*, 144 Tex. 393, 190 S.W. 2d 802, 804 (1945).

Such wells have to be shut in if there is not way to transport their gas production from the lease. The wasteful flaring or venting of natural gas is prohibited in Texas. TEX. NAT. RES. CODE ANN. §85.046(9) (Vernon 1978, Supp. 1984) and 86.012(b) (Vernon 1978 & Supp. 1984). If the production in a field is not ratably divided among all the wells in a field, and interstate pipelines are free to take only from wells whose owners have met their terms, then marginal wells may be destroyed. Oil and gas will be wasted. Such actions violate TEX. NAT. RES. CODE ANN. §85.123 (Vernon 1978) and defeat the polices announced in the NGPA.

There are other situation in which the Texas Railroad Commission must adjust the production allowables of specific wells in a field in order to maximize the recovery of hydrocarbons. *Texaco, Inc. v. Railroad Commission*, 583 S.W. 2d 207, 310 (Tex. 1979). Oil and gas reservoirs are not uniform in structure, and the locations from which oil and gas is drawn from the ground can increase or decrease recovery. If interstate

pipelines are permitted to ignore these production orders and take only from the wells whose producers signed contracts with the pipeline, then waste will result and sound engineering principles will be ignored.

As long ago as 1900, this Court held that the States' powers to promote the conservation of oil and gas rests in their police powers. *Ohio Oil Co. v. State of Indiana*, 177 U.S. 190 (1900). The regulation of the production of natural gas is a valid exercise of the police power of the State of Texas. *Railroad Commission v. Aluminum Co. of America*, 380 S.W. 2d 599, 602 (Tex. 1964). When Congress legislates in a field in which the statutes have traditionally exercised their police powers this Court starts. "[w]ith the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." *Pacific Gas and Electric*, 103 S. Ct. at 1723 (quoting *Rice v. Sante Fe Elevator Corp.*, 331 U.S. 318, 230 (1947). There is no clear and manifest preemption of State ratable take orders. Such orders further the goals of federal law. These orders ensure greater supplies of natural gas and thus serve the policy interest of the NGPA.

The State of Texas wishes to impress upon this Court that the State's ratable take orders serve the national interest and are not intended to further parochial interests or discriminate against other States. Nor are these orders an attempt to indirectly regulate wellhead sales. Instead, Texas is using a historic police power to prevent the waste of natural gas. The NGPA was not intended to preempt this exercise of the States' historic police powers.

II. THE COMMERCE CLAUSE QUESTION SHOULD BE THE CONTROLLING ISSUE IN THE CASE.

This Court's decision in *Peerless* illustrates that State order requiring interstate pipelines to take ratably are not necessarily invalidated by the Commerce Clause. Since the preemption question is disposed of by the changes in federal law wrought by the passage of the NGPA, the controlling issue in this case should be whether Mississippi's order is invalidated by the Commerce Clause.

This Court has previously held that a state ratable take order issued to an interstate gas purchaser does not violate the Commerce Clause. *Peerless,* supra. The subsequent decision in *Northern Natural* invalidated a state order not because it was an impermissible burden on commerce but because the order was preempted by the NGA. This Court pointed out in *Northern Natural* that as to constitutional challenges the *Peerless* decision was not overruled. *Northern Natural,* 372, U.S. at 91, n. 10.

The State of Texas believes that the explanation of Mississippi's particular system of ratable take is best left to Mississippi. However, the State of Texas does agree that the protection of correlative rights (like the prevention of waste and drainage) is a legitimate local interest that should be protected by a State's police powers. Further, the appellee Transco has not demonstrated an excessive burden in interstate commerce. Instead, the only burden is on Transco itself as a result of gas purchase contracts which Transco freely entered into. In any case Texas believes that its own system of ratable take, which is similar to the Oklahoma Common Purchaser Act that was upheld in *Peerless,* does not violate the Commerce Clause. When deciding the present case now before it, Texas request his Court to consider that State ratable take orders are valid exercises of State police powers.

CONCLUSION

For the foregoing reasons, the State of Texas as amicus curiae respectuflly submits that the decison of the Mississippi Supreme Court is sound in policy as well as law. We respectfully urge this Court to affirm the decision below.

Respectfully,

JIM MATTOX
Attorney General of Texas

DAVID R. RICHARDS
Executive Assistant
Attorney General

LARRY J. LAURENT
Assistant Attorney General
Chief, Energy Division

MANUEL RIOS*
Assistant Attorney General
P.O. Box 12548, Capitol Station
Austin, Texas 78711-2548
(512) 475-1101

Attorneys for
The State of Texas

**Counsel of Record*

MOTION FILED
OCT - 1 1985

No. 84-1076 (17)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI
AND
COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF FOR THE STATE OF LOUISIANA AS AMICUS CURIAE

*DAVID B. ROBINSON
DEBORAH M. LODGE
PATTON, BOGGS & BLOW
2550 M Street, N.W.
Washington, D.C. 20037
(202) 457-6000

Attorneys for
The State of Louisiana

HONORABLE EDWIN W. EDWARDS
Governor, State of Louisiana
HONORABLE WILLIAM J. GUSTE, JR.
Attorney General, State of Louisiana
HONORABLE B. JIM PORTER
Secretary, Department of Natural Resources, State of Louisiana
HONORABLE HERBERT W. THOMPSON
Assistant Secretary, Commissioner of Conservation, State of Louisiana

October 1, 1985

*Counsel of Record

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

BEST AVAILABLE COPY

16 P

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI
AND
COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

MOTION OF THE STATE OF LOUISIANA FOR LEAVE TO FILE BRIEF AMICUS CURIAE

The State of Louisiana respectfully moves for leave to file a brief amicus curiae. Although consent of the parties is not required, pursuant to Rule 36.4, because the brief is presented for a state, Louisiana is filing this motion because it is aware that, unless this motion is granted, its brief amicus curiae would be considered untimely.

Louisiana is a major natural gas producing state and, in order to conserve its natural gas resources, has enacted "ratable take" statutory provisions similar to Rule 48 o_ the Mississippi Oil and Gas Board. Accordingly, a decision of this Court invalidating Mississippi's Rule 48 would cast serious doubt upon the validity of Louisiana's ratable take provisions. The

State of Louisiana thus has a direct interest in the issues raised by this case and believes that its brief amicus curiae would assist this Court in rendering its decision.

Louisiana was unable to submit its brief amicus curiae earlier due to its limited legal resources. It is respectfully requested that the Court grant this motion in order to permit Louisiana to call to the attention of the Court its interest in this case, in which the validity of its statute may be drawn into question.

Respectfully submitted,

*David B. Robinson
Deborah M. Lodge
Patton, Boggs & Blow
2550 M Street, N.W.
Washington, D.C. 20037
(202) 457-6000

Attorneys for
The State of Louisiana

Honorable Edwin W. Edwards
Governor, State of Louisiana

Honorable William J. Guste, Jr.
Attorney General, State of Louisiana

Honorable B. Jim Porter
Secretary, Department of Natural Resources, State of Louisiana

Honorable Herbert W. Thompson
Assistant Secretary, Commissioner of Conservation, State of Louisiana

**Counsel of Record*

By: _____
David B. Robinson

October 1, 1985

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI
AND
COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

BRIEF FOR THE STATE OF LOUISIANA AS AMICUS CURIAE

*DAVID B. ROBINSON
DEBORAH M. LODGE
PATTON, BOGGS & BLOW
2550 M Street, N.W.
Washington, D.C. 20037
(202) 457-6000

Attorneys for
The State of Louisiana

HONORABLE EDWIN W. EDWARDS
Governor, State of Louisiana
HONORABLE WILLIAM J. GUSTE, JR.
Attorney General, State of Louisiana
HONORABLE B. JIM PORTER
Secretary, Department of Natural Resources, State of Louisiana
HONORABLE HERBERT W. THOMPSON
Assistant Secretary, Commissioner of Conservation, State of Louisiana

October 1, 1985

*Counsel of Record

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

INTEREST OF AMICUS CURIAE 1

SUMMARY OF ARGUMENT 2

ARGUMENT:

Mississippi's Ratable Take Order Has Not Been Preempted By Federal Statute 3

Mississippi's Ratable Take Order Furthers the Legitimate Interests of the State and Does Not Unduly Burden Interstate Commerce 4

CONCLUSION 6

TABLE OF AUTHORITIES

CASES:	Page
Gibbons v. Ogden, 9 Wheat 1 (1824)	3
Hillsborough County, Florida v. Automated Medicated Laboratories, Inc., —— U.S. ——, 105 S.Ct. 2371 (1985)	3
Northern Natural Gas Co. v. State Corporation Commission of Kansas, 372 U.S. 84 (1963)	3
Pike v. Bruce Church, Inc., 397 U.S. 137 (1970)	4
CONSTITUTIONAL PROVISIONS:	
U.S. Const. Art. VI, Cl. 2	3
STATUTES:	
15 U.S.C. §§ 717 et seq.	2
15 U.S.C. § 717c	4
15 U.S.C. § 717f	4
15 U.S.C. § 3301 et seq.	2
15 U.S.C. § 3331(b)	4
15 U.S.C. § 3431(a)	4
Title 30, L.R.S. § 42	2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI
AND
COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

BRIEF FOR THE STATE OF LOUISIANA AS AMICUS CURIAE

INTEREST OF AMICUS CURIAE

The State of Louisiana, a major natural gas producing state, regulates the development of gas reserves in Louisiana to maximize production over the life of the reservoir, to avoid drainage, and to assure that pipeline purchasers do not unfairly discriminate as between owners of gas in a single reservoir. The conservation of natural gas resources, promoted by Louisiana's regulation, is important not only to Louisiana but to the nation as a whole.

To promote conservation and to prevent drainage and discrimination, the Louisiana legislature has enacted "ratable take" statutory provisions whose validity would be cast in serious doubt by a ruling of this Court invalidating Rule 48 of the Mississippi Oil and Gas Board. *See* Title 30, L.R.S. § 42.

The State of Louisiana thus has a direct interest in the issues raised by this case, as those issues affect the ability of a state to manage the development of natural gas reserves in a way that best serves the interests of conservation and equity.

SUMMARY OF ARGUMENT

1. Congress has not preempted the states' ability to enforce ratable take provisions for purchases of deregulated natural gas. In the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3301 *et seq.*, Congress removed such purchases from the jurisdiction of the Federal Energy Regulatory Commission under the Natural Gas Act ("NGA"), 15 U.S.C. §§ 717 *et seq.* This Court should thus give deference to Mississippi's decision to regulate the manner in which its natural resources are developed through ratable take provisions.

2. The ratable take provisions do not impose an unreasonable burden on interstate commerce. Indeed, in the absence of federal authority to regulate, the states must regulate in order to avoid the creation of an intolerable regulatory gap. When Transcontinental Gas Pipe Line Corporation ("Transco") contracted with some, but not all, of the producers of gas from a reservoir, it did so with full knowledge of the State's ratable take authority. Transco need not take any gas from a

reservoir in Mississippi; but if it does take, it must take ratably and without undue discrimination.

ARGUMENT

Mississippi's Ratable Take Order Has Not Been Preempted by Federal Statute.

State laws that "interfere with or are contrary to" federal law are preempted pursuant to the Supremacy Clause, U.S. Const. Art. VI, Cl. 2. *Gibbons* v. *Ogden*, 9 Wheat 1, 211 (1824). As this Court recently observed in *Hillsborough County, Florida* v. *Automated Medicated Laboratories, Inc.*, —— U.S. ——, 105 S. Ct. 2371, 2375 (1985), a conclusion that a state law is preempted by a federal statute generally is based on a finding (1) that Congress has expressly preempted state law; (2) that federal regulation of the area is so comprehensive as to justify the inference that Congress "left no room" for state regulation; or (3) that the field is one of such dominant federal interest as to preclude state regulation. None of these criteria supports a conclusion that Mississippi's regulation has been preempted.

The NGPA removed sales of "high cost" gas to producers altogether from the federal controls imposed by the Natural Gas Act. The NGPA does not explicitly or implicitly preempt state regulation.

Federal regulation is no longer so comprehensive as to displace state law. In *Northern Natural Gas Co.* v. *State Corporation Commission of Kansas*, 372 U.S. 84 (1963), this Court held that the NGA so "pervasively regulated" interstate sales and distribution of natural gas that a state ratable take regulation was preempted. Under the NGA, all producers wishing to sell gas in

interstate commerce were required first to obtain the prior permission (by the issuance of a certificate) of the Federal Power Commission ("FPC") or its successor agency, the Federal Energy Regulatory Commission ("FERC"). The brokerees were permitted to make sales only upon terms and conditions expressly authorized by the FPC or the FERC, and the price, terms, and conditions of the sale were comprehensively regulated. NGA §§ 4, 7, 15 U.S.C. §§ 717c, i. Entrpet, a brokeree could not halt a sale, once begun, without first receiving abandonment authorization from the Federal Power Commission. NGA § 7(b), 15 U.S.C. § 717f(b). The requirements of the Natural Gas Act were reheared as to the gas at issue in this case by Sections 151(b) and 103(a)(1)(B) of the NGPA. 15 U.S.C. §§ 3331(b), 3341(a)(1)(B). The NGPA was enacted with the express purpose of removing such gas from the regulatory authority of the FERC. Since federal authority no longer regulates the sale at issue here, the state must be free to regulate them in the interests of their conservation of its resources.

Mississippi's Example Take Order Furthers the Legitimate Interests of the State and Does Not Unduly Burden Interstate Commerce.

This Court articulated the applicable standard for assessing whether a state regulation impermissibly burdens interstate commerce in Pike v. Bruce Church, Inc., 397 U.S. 137, 145 (1970):

> Where the [state] statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.

Under this standard, the state action embodied in Mississippi's latable take order must be upheld. Mississippi's latable take order was issued in response to a clear need to regulate takes in light of the geological characteristics of natural gas reservoirs. Latable take orders are especially appropriate in conditions of oversupply, such as those presently today.

In times of oversupply, pipeline purchasers, in the absence of latable take orders, may discriminate against smaller producers and land owners, and they may take in ways which are inconsistent with prudent long-term development of a reservoir.*

With the passage of the NGPA, the FERC is no longer able to control sales of deregulated gas by producers to interstate pipelines. The federal authority is thus now unable to deal with the problems which latable take orders are designed to address. Unless state authorities are free to deal with them, an intolerable regulatory gap will be created.

Any problem on interstate commerce that would be caused by the enforcement of the latable take order are of Texaco's making. Texaco is not required to purchase gas gas from a reservoir, but, if it does, it must purchase latably. Texaco should not be allowed to use the Commerce Clause of the Constitution as a shield from contracts no longer bargainable to it or to protect itself against its own purchasing decisions. At the time it entered into its contracts, Texaco did so with full knowledge of the state authority to require latable takes.

---

* The American Courts print of the State of Texas (pp. 9-11) photograph explains the reasons latable take orders are in certain circumstances essential to promote conservation.

CONCLUSION

For the foregoing reasons, this Court should affirm the decision of the Mississippi Supreme Court.

Respectfully submitted,

*David B. Robinson
Deborah M. Lodge
Patton, Boggs & Blow
2550 M Street, N.W.
Washington, D.C. 20037
(202) 457-6000
Attorneys for
The State of Louisiana

Honorable Edwin W. Edwards
Governor, State of Louisiana

Honorable William L. Guste, Jr.
Attorney General, State of Louisiana

Honorable B. Jim Porter
Secretary, Department of Natural
Resources, State of Louisiana

Honorable Herbert W. Thompson
Assistant Secretary, Commissioner
of Conservation, State of Louisiana
*Counsel of Record

By: David B. Robinson

October 1, 1982

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing Motion for Leave to File Brief Amicus Curiae and Brief for the State of Louisiana as Amicus Curiae, by mailing first-class, postage pre-paid, three copies to counsel listed below:

Edwin Lloyd Pittman
Attorney General
State of Mississippi
Post Office Box 220
Jackson, Mississippi 39205

John Marshall Cromer, Esquire
Brunini, Grantham, Grower & Hewes
Post Office Drawer 119
Jackson, Mississippi 39205

R. V. Loftin, Jr., Esquire
Post Office Box 1398
Houston, Texas 77251

Frederick Moting, Esquire
Cromelt & Morino
1100 Connecticut Avenue, N.W.
Washington, D.C. 20036

Honorable Rex E. Lee
Solicitor General
Department of Justice
Washington, D.C. 20530

Glenn Gates Taylor, Esquire
Heidelberg, Woodliff & Franks
Suite 1030 Capitol Towers
Jackson, Mississippi 39201

Walker L. Walters, Esquire
GERALD, BRAND, WATTERS, COX & HEMLEBEN
400 Lamar Life Building
Jackson, Mississippi 39201

John Land McDavid, Esquire
McDAVID, EDMONSON & NOBLIN
8th Floor, City Center North
501 S. Lamar Street
Jackson, Mississippi 39201

William L. Waller, Esquire
WALLER & WALLER
412 East Capitol Street
Jackson, Mississippi 39201

Vernon L. Terrell, Jr., Esquire
FRANCHE, HARTLEY, LAPEYRE & OTTINGER
Suite 3018 One Shell Square
New Orleans, Louisiana 70139

Tim Mattox
Attorney General
State of Texas
Post Office Box 12548
Capitol Station
Austin, Texas 78711

John H. Cheatham III
1600 L Street, N.W.
Washington, D.C. 20036

Harold H. Tallisman
WRIGHT & TALISMAN, P.C.
1020 19th Street, N.W.
Suite 600
Washington, D.C. 20036

David B. Kopinson

Dated: October 1, 1982

David Crump
Legal Foundation of America
1303 San Jacinto
Houston, Texas 77002

MOTION FILED

DEC - 9 1985

No. 84-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

MOTION OF COASTAL EXPLORATION, INC. TO FILE SUPPLEMENTAL BRIEF AFTER ARGUMENT AND SUPPLEMENTAL BRIEF

GLENN GATES TAYLOR
(Counsel of Record)
JAMES RUSSELL TUCKER
COPELAND, COOK, TAYLOR & BUSH
Suite 112 Capital Towers
Post Office Drawer 2132
Jackson, Mississippi 39225
(601) 354-0123

KENNETH I. FRANKS
HEIDELBERG, WOODLIFF & FRANKS
Suite 1400 Capital Towers
Jackson, Mississippi 39201
(601) 948-3800

Attorneys for Coastal Exploration, Inc.

December 9, 1985

BEST AVAILABLE COPY

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

MOTION OF COASTAL EXPLORATION, INC. TO FILE SUPPLEMENTAL BRIEF AFTER ARGUMENT

Coastal Exploration, Inc. ("Coastal"), Appellee, moves the Court pursuant to Rule 35.5 to allow it to present by Supplemental Brief a certain intervening matter that was not available in time to have been included in Coastal's brief in chief, being a matter which has intervened since the oral argument of this case on October 8, 1985, as follows:

1. Appellant Transco's brief in chief (at pages 14-15) and the brief of the FERC (at pages 21-22) refer to inquiries which the FERC has opened into Transco's purchases of gas, and represent that Mississippi's ratable take requirement, at issue, may conflict with or frustrate the FERC's exercise of its jurisdiction under NGPA § 601(c)(2), a claim which Coastal dis-

putes. On October 31, 1985, the FERC issued an Initial Decision in *Transcontinental Gas Pipe Line Corporation*, FERC Docket No. TA85-3-29-008, which finds, *inter alia*, that "Transco's purchase practices of volumes from the Greens Creek and East Morgantown Fields have not been imprudent and have not resulted in unjust and unreasonable rates." *Id.* at page 7.

2. The Court should be advised of this intervening matter as more fully set forth in the accompanying Supplemental Brief.

WHEREFORE, PREMISES CONSIDERED, Coastal moves the Court for leave to file a Supplemental Brief in order to present the foregoing intervening matter.

THIS, the 9th day of December, 1985.

Respectfully submitted,

GLENN GATES TAYLOR
(Counsel of Record)
JAMES RUSSELL TUCKER
COPELAND, COOK, TAYLOR & BUSH
Suite 112 Capital Towers
Post Office Drawer 2132
Jackson, Mississippi 39225
(601) 354-0123

KENNETH I. FRANKS
HEIDELBERG, WOODLIFF & FRANKS
Suite 1400 Capital Towers
Jackson, Mississippi 39201
(601) 948-3800

Attorneys for Coastal Exploration, Inc.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

SUPPLEMENTAL BRIEF IN SUPPORT OF MOTION OF COASTAL EXPLORATION, INC. TO FILE SUPPLEMENTAL BRIEF AFTER ARGUMENT

Appellant Transco's brief in chief (at pages 14-15) and the brief of FERC (at pages 21-22) refer to inquiries which the FERC has opened into Transco's purchases of gas. In their respective briefs, Transco and FERC represent that Mississippi's ratable take requirement, at issue, may conflict with or frustrate the FERC's exercise of its jurisdiction under NGPA 601(c)(2), a claim which Coastal disputes.

Additionally, at the oral argument of this case on October 8, 1985, the FERC implied that payment of the price ordered by the Mississippi Supreme Court

might constitute fraud or abuse and thus FERC might prohibit Transco from passing through these gas costs. Witness the following excerpts from the oral argument of Jerome M. Feit, Solicitor, Federal Energy Commission:

> But, in addition to that kind of scheme—in addition to that, FERC did have specific authority under Title VI of the Natural Gas Policy Act to prohibit the pass through of such gas costs which is found to be the product of fraud, abuse, or similar grounds.
>
> So, what you had was just the opposite of a commission of state intervention. You had a free market under Title I which FERC could not interfere with as you pointed out in the Mid-Louisiana opinion. And, on the other hand, you had FERC's control to assume that gas costs—that pricing practices of pipe lines are not fraud, abusive, or invalid on similar grounds from passing through. That is the Natural——
>
> Question: Would you fit this under the fraud or abuse section?
>
> Mr. Feit: I don't know if—My point is the power exists. I don't know whether in fact this amounts to fraud or abuse or similar grounds. It seems to me——
>
> Question: The power only exists if it does amount to that.
>
> Mr. Feit: Well, the power to impose denial to pass through exists.
>
> Question: Right.

Transcript of Oral Argument of October 8, 1985, at pp. 16-17.

In this connection, Coastal wishes to bring to the Court's attention FERC's Initial Decision issued October 31, 1985 in *Transcontinental Gas Pipe Line Corporation,* FERC Docket No. TA85-3-29-008. Considering the identical factual situation posed in Transco's and FERC's briefs and at oral argument by FERC counsel, the Initial Decision of FERC found, *inter alia,* that "Transco's purchase practices of volumes from the Greens Creek and East Morgantown Fields have not been imprudent and have not resulted in unjust and unreasonable rates." *Id.* at page 7. Attached as an Appendix is a copy of the FERC opinion.

DATED, this the 9th day of December, 1985.

Respectfully submitted,

GLENN GATES TAYLOR
(Counsel of Record)
JAMES RUSSELL TUCKER
COPELAND, COOK, TAYLOR & BUSH
Suite 112 Capital Towers
Post Office Drawer 2132
Jackson, Mississippi 39225
(601) 354-0123

KENNETH I. FRANKS
HEIDELBERG, WOODLIFF & FRANKS
Suite 1400 Capital Towers
Jackson, Mississippi 39201
(601) 948-3800

Attorneys for Coastal Exploration, Inc.

APPENDIX

APPENDIX

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. TA85-3-29-008

(Purchase Practices—Mississippi-Louisiana Issue)

TRANSCONTINENTAL GAS PIPE LINE CORPORATION

INITIAL DECISION

(October 31, 1985)

APPEARANCES*

R. V. Loftin, Jr., Thomas E. Skains, David A. Glenn, Thomas F. Ryan, Jr., Robert G. Hardy, and *Michael J. Fremuth* for Transcontinental Gas Pipe Line Corporation

Frederick Moring, Joseph M. Oliver, Jr., and *M. Lisanne Crowley* for Associated Gas Distributors

Sandra Delude, Kenneth M. Ende, Lawrence W. Lebow, and *Daniel Watkiss* for the Staff of the Federal Energy Regulatory Commission

MEGAN, Presiding Administrative Law Judge

I. INTRODUCTION

This proceeding presents the age-old conflict between state and federal regulation of commerce. The situation is this: Transcontinental Gas Pipe Line Corpora-

---

* Other counsel have made appearances in Docket No. TA85-1-29-005 involving the first phase of this proceeding designated the Sulpetro Issue. *See* 32 FERC ¶ 63,081.

tion (Transco) operates a major natural gas transmission system. From its sources of supply in Texas, Louisiana, Mississippi and the Gulf of Mexico, the Transco system extends through the southeastern United States and up the eastern seaboard to its terminus in the New York City-Long Island area. Through its distributor customers, Transco serves many of the major market areas of the eastern United States, including Atlanta, Washington, D.C., Philadelphia and New York City.

One of the sources of supply of gas in Mississippi is the Harper Sand Gas Pool in the Greens Creek and East Morgantown fields in Marion County. In these fields, all of the production from the Harper Sand Gas Pool is below 15,000 feet and thus "high cost gas" under section 107(c) of the Natural Gas Policy Act (NGPA), 15 U.S.C. § 3317(c) (1982). Transco has executed purchase contracts with some, but not all, producers who own a working interest in the Harper Sand Gas Pool. Most, if not all, of Transco's contracts contain take-or-pay clauses. These clauses require a pipeline to purchase a specified minimum quantity of gas, or in any event to pay for that minimum quantity of gas if it is made available by the producer and not taken by the pipeline. Most take-or-pay provisions include a "make-up right" under which the purchaser is entitled at a later time to receive those gas volumes paid for but not previously taken.

In an enforcement proceeding brought against Transco, the State Oil and Gas Board of Mississippi, acting pursuant to Statewide Rule 48 (a ratable take rule), ordered Transco to take gas ratably from all owners, operators or producers in the Harper Sand Gas Pool. That rule provides:

> Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, or producers shall purchase without discrimination in favor of one owner, operator, or producer against another in the same common source of supply. Miss. Code Ann. § 53-1-1 (1972).

Under this rule, if Transco takes gas at any time from the Harper Sand Gas Pool from producers with whom it has contracts (signatory producers), it is also required to take from producers with whom Transco does not have contracts (non-signatory producers), gas in volumes that equate to the same percentage of each producer's working interest in the Harper Sand Gas Pool. In effect, Transco has been ordered to take more high cost gas than it has contracted or planned for. On the other hand, if Transco were to reduce its takes from non-signatory producers, Transco would incur take-or-pay liabilities to those signatory producers whose contracts contain take-or-pay clauses.

In addition to the Harper Sand Gas Pool, Transco has been purchasing and will continue to purchase gas produced from the Vermilion Block 370 Field, located in Offshore Louisiana. Transco has not cut back its takes from the Vermilion Block 370 Field because Transco has prepaid for these volumes under contractual take-or-pay obligations. It has taken higher levels of production from this source than it otherwise would have taken in order to recoup the prepaid volumes. At the time Transco made prepayments for gas not taken from the Vermilion Block 370 Field, it paid the then current maximum lawful price (MLP) under Title I of the NGPA. When Transco later made up the prepaid volumes, it paid an additional amount of money representing the increase in the MLP over the

MLP in effect at the time Transco made the prepayments.

What is here now designated as the Mississippi-Louisiana Issue, is the second part of a three-part proceeding involving recent rate filings by Transco. The first part, designated the Sulpetro Issue, was the subject of an Initial Decision by me on September 3, 1985 (32 FERC ¶ 63,081). I there concluded that Transco should be permitted to recover in its purchased gas adjustment (PGA) filings the cost of Canadian gas purchased from Transco's Canadian supplier, Sulpetro, on an "as-billed" basis. The third part of the proceeding will deal with Transco's other purchase practices as provided for in the Commission's Order of April 30, 1985. A hearing on that issue was held before me on October 22, 1985. It was unnecessary to hold a hearing on the Mississippi-Louisiana Issue because the parties involved, Transco and Associated Gas Distributors (AGD), have entered into a Stipulation of Facts, Exhibit 1, as supplemented with prepayment data on July 26 and August 8, 1985, Exhibits 2 and 3. Transco, AGD and Staff have filed briefs herein.

This proceeding began on September 28, 1984 when Transco filed various tariff sheets to implement its PGA pursuant to the terms of its FERC Gas Tariff. On March 29, 1985, Transco tendered for filing its most recent PGA-type rate change. A number of parties, including AGD, raised issues concerning the justness and reasonableness of Transco's purchasing practices as they are reflected in its PGA. In its Order of April 30, 1985, the Commission acknowledged these protests and ordered the PGA dockets to hearing. Since the Mississippi-Louisiana Issue was the subject of a Stip-

ulation between the parties affected, this issue has been separated out from other purchase practices of Transco and will be the subject of this Initial Decision.

II. THE ISSUES PRESENTED AND THE POSITION OF THE PARTIES

Two issues are presented by the Stipulation of Facts, a copy of which is appended hereto as Appendix A:

1. Whether Transco's gas purchases in the Greens Creek and East Morgantown fields in Marion County, Mississippi, which are subject to a ratable take order of the State Oil and Gas Board of Mississippi, have been imprudent and have resulted in unjust and unreasonable rates.

2. Whether a producer or producers delivering make-up gas to Transco from the Vermilion Block 370 field received for that gas a price in excess of the maximum lawful price allowed by Title I of the NGPA, 15 U.S.C. § 3311-3320 (1982).

AGD and Staff take the position that Transco's compliance with the State Oil and Gas Board of Mississippi's order results in unlawful Transco rates. Specifically, AGD states at page 14 of its Initial Brief:

> The Mississippi ratable take order obligates Transco to take gas ratably from all owners, operators, and producers—both signatory and nonsignatory—who produce gas from the Harper Sand Gas Pool, if it takes any gas from that source at all. Transco acknowledges tht the practical effect of compliance with this order is that it must either reduce its takes from those producers with whom it has contracts, thereby incurring increased take-or-pay liabilities, or increase its total takes of this

> high-cost gas to amounts which it did not plan for and perhaps may not be able to sell to its customers. Either alternative is inconsistent with a "least reasonable (sic) cost" gas purchasing policy. Transco's compliance with the ratable take order therefore constitutes a continuing situation of imprudent purchasing practices in violation of NGA Section 4 and 5. *It is imperative that the Presiding Judge and the Commission take immediate action to declare unlawful an interstate pipeline's adherence to a state law which frustrates the pipeline's ability to comply with its federal statutory responsibilities.* (Emphasis supplied)

On the other hand, Staff argues in its Initial Brief at pages 15-16 that:

> * * * Transco's purchases made pursuant to Mississippi Rule 48 should be found to be unjust and unreasonable because Rule 48 prevents Transco from pursuing a least-cost purchasing strategy and results in higher costs being passed on to the ultimate consumers. The Commission should therefore exercise its exclusive jurisdiction over Transco's purchasing practices and direct Transco to pursue a least-cost purchasing strategy *irrespective of Rule 48.*

As to the second or Title I issue, both the Staff and AGD contend that Transco's prepayments for Vermilion Block 370 gas violates Title I of the NGPA because the time value of the money received by the producer from such prepayments, when added to the payments made by Transco at the time that the gas is actually taken, exceeds the maximum lawful price under Title I of the NGPA, 13 U.S.C. §§ 3311-3333.

For a remedy, Staff states that the *producers* should refund the $3.3 million figure claimed to represent the time value of money received by such producers for Transco's prepaid Vermilion Block 370 gas. AGD, on the other hand, states that *Transco* should be denied passthrough of such amounts and that Transco should refund the $3.3 million to its customers.

Transco, of course, resists these contentions, arguing that it cannot disregard the Mississippi Board's order under Rule 48 which Transco has appealed all the way to the United States Supreme Court. On the Title I issue, Transco states that the time value of prepayments is a generic problem which should be addressed on an industry-wide basis. Transco also argues that Title I problems do not belong in PGA proceedings because relief runs not against the purchaser, here Transco, and is not properly administered through the PGA mechanism.

III. DISCUSSION

It seems obvious to me that if we are to continue to follow the rule of law in this country, a party should not be placed in jeopardy for obeying an order of a duly constituted authority while that party undertakes successive appeals seeking to overturn an adverse decision. Here Transco was ordered by the Mississippi Board to abide by Rule 48, a perfectly equitable method of handling gas production from the Harper Sand Gas Pool. Disagreeing with the Board's decision, Transco appealed under Mississippi law to the Circuit Court which upheld the Board. There followed an appeal to the Supreme Court of Mississippi which upheld the ratable take requirement in its decision of September 5, 1984, reported as *Transconti-*

nental Gas Pipeline Corporation, v. The State Oil and Gas Board of Mississippi, 457 So. 2d 1298 (Miss. 1984). Thereafter, Transco noticed its appeal to the Supreme Court of the United States where oral arguments were heard October 8, 1985 (No. 84-1076).

I am clear that the law of this case today lies in the decision of the Supreme Court of Mississippi and its holding will continue to govern this proceeding until the United States Supreme Court hands down its decision on appeal. It is simply not acceptable for AGD and Staff to direct Transco to ignore and even flout the Mississippi holdings and require Transco to conduct its affairs *"irrespective of Rule 48."* In my view, Transco is entitled, indeed is required, to follow the decisions and orders of the Mississippi authorities until and unless they be overturned by the Supreme Court of the United States. Any other view would abrogate the rule of law and invite litigants to go about making up their own minds whether or not they would abide by decisions of duly constituted authority.

It also seems presumptuous for AGD and Staff to assume, as they apparently do, that the Supreme Court of the United States will automatically reverse the decision of the Supreme Court of Mississippi. The state court's decision is a powerful statement in support of the legality of Rule 48 as here applied. AGD and Staff beg the question in arguing from the premise that "the federal law in this case preempts all conflicting state regulation." AGD Initial Brief 21; Staff Initial Brief 8-13. The result of the Court's deliberation is hardly a foregone conclusion. It is likely that the court will review this constitutional issue broadly, since it is primarily a question of law rather than fact, and it involves one of FERC's own authorization

statutes. *Hi-Craft Clothing Co.* v. *NLRB*, 660 F.2d 910, 914-16 (D.D.C. 1981) (citing U.S. Supreme Court cases); 5 K. Davis, *Administrative Law Treatise*, § 29:14 (2d ed. 1984). Further, recent decisions indicate the Court's increased willingness to review the validity of state and federal agency policy. Davis, *supra* § 29:15. At any rate, the proper time for this Commission to act is after the Supreme Court decides the case at which point all concerned may be guided accordingly.

As to the second or Title I issue, I agree with Transco that this is not the time and place to become involved in the question of the legitimacy of payments which allegedly did not properly account for their time value. Of paramount consideration in this regard is the absence from this proceeding of the producers who may be required to disgorge any monies in excess of the limits provided in the NGPA. Justice certainly requires that the interests of producers be considered. Yet Staff would have me direct the producers, names unknown on this record, to refund the amounts represented by the time value of Transco's prepayments, a total of $3,380,685.74. (Staff Initial Brief, pp. 21-22). AGD would go further by demanding that Transco pay these refunds and, prospectively, not pass the excessive amounts through to its customers. (AGD Initial Brief, pp. 32, 34). It is noted that AGD in its Reply Brief softens this demand for relief by recommending that the Presiding Judge should make Transco's compliance actions ". . . coincide with its receipt of refunds from its supplier or suppliers of gas from the Vermilion Block 370, the latter to occur as a result of such enforcement or other proceedings as are chosen by the Commission." (Reply Brief, pp. 11-12). These

suggestions are rejected. Far better is the suggestion that time value problems be the subject of a separate Commission generic investigation wherein the interests of all parties may be presented and an informed decision be promulgated.

In its Reply Brief Staff asserts that the only Louisiana producer affected by the outcome of this proceeding is Shell Offshore, Inc. which is a party herein and presumably fully knowedgeable on this issue. I am reluctant to accept this argument, primarily because the Stipulation of Facts upon which this decision is based does not state that Shell is the only producer affected by this proceeding; indeed it identifies no producers.

IV. CONCLUSION

It follows that, subject to review by this Commission, I find:

1. Transco's purchase practices of volumes from the Greens Creek and East Morgantown fields have not been imprudent and have not resulted in unjust and unreasonable rates.

2. Based on the record in this proceeding, this is not the proper forum to consider problems involving the time value of money for prepayment of gas in the Vermilion Block 370 Field as proposed by AGD and staff.

/s/ THOMAS I. MEGAN
Thomas I Megan
Presiding Administrative Law Judge

Appendix A

STIPULATION OF FACTS

Associated Gas Distributors (AGD) and Transcontinental Gas Pie Line Corporation (Transco) stipulate that the following facts are true, that they are jointly tendered, and that they are admissible into evidence in lieu of testimony. The entry of this stipulation is limited solely to those matters expressly provided herein and shall not signify any agreement by the parties that all of the facts stipulated herein are material or relevant to the issues in this proceeding, or that all of the subject matters covered hereby are appropriate issues in this proceeding, nor shall the entry of this stipulation act as a bar to any rights of the parties hereto including, but not limited to, the right to object to the materiality or relevance of any matters stated herein.

A. Mississippi Volumes

1. During the periods covered by the two PGA filings in the instant dockets, Transco has purchased and will purchase gas produced from the Greens Creek and East Morgantown fields in Marion County, Mississippi.[1]

2. Portions of both the Greens Creek Field and the East Morgantown Field are underlied by the Harper Sand Gas Pool.

3. The Harper Sand Gas Pool lies below 15,000 feet. All of the wells producing from this pool have been

---

[1] *See*, for example, Transco Tracking Rate Filing to be Effective November 1, 1984, Appendix C at 152 *et seq.* and 167 *et seq.*

classified as "dereguated deep, high-cost wells" under § 107(c)(1) of the NGPA, 15 U.S.C. § 3317(c)(1) (1982).

4. Transco has natural gas supply contracts with Mississippi producers whose gas wells produce from the Harper Sand Gas Pool.

5. Most, if not all, of Transco's supply contracts for gas produced from the Harper Sand Gas Pool contain take-or-pay clauses.

6. Transco does not have supply contracts with all producers who own interests in the Harper Sand Gas Pool.

7. In an enforcement proceeding brought against Transco, the State Oil and Gas Board of Mississippi (the "Mississippi Board"), acting pursuant to Statewide Rule 48, ordered Transco to take gas ratably from all owners, operators, or producers in the Harper Sand Gas Pool. This order was upheld on appeal of the Mississippi court of appeals and, thereafter, the Mississippi Supreme Court. The merits of this order are now pending review by the U.S. Supreme Court in Transcontinental Gas Pipe Line Corp. v. The State Oil and Gas Board of Mississippi *et al.*, No. 84-1076.

8. Under the Mississippi Board's ratable take rule, if Transco takes gas at any time from the Harper Sand Gas Pool producers with whom it has contracts (the signatory producers), it was ordered to take gas in volumes which equate to the same percentage of each producer's working interest in the Harper Sand Gas Pool from producers with whom Transco does not have contracts (the nonsignatory producers). Under the Mississippi Board's order, Transco has been

ordered to take more deregulated gas from the Harper Sand Gas Pool than Transco contracted or planned for.

9. If Transco reduces its takes from the signatory producers to account for the corresponding volumes it has been ordered to take from nonsignatory producers, Transco may incur take-or-pay liabilities on those contracts which contain take-or-pay clauses.

B. Payment Makeup Volumes

1. During the periods covered by the two PGA filings in these two dockets, Transco has purchased and will purchase gas produced from the Vermillion 370 Field, located in offshore Louisiana.[2]

2. Transco has protected its takes from the Vermillion 370 Field against cutbacks in production because Transco prepaid for these volumes under take-or-pay contractual obligations. Therefore, Transco was required to take higher levels of production from this source than it otherwise would have taken in order to recoup the prepaid volumes.

3. At the time Transco made prepayments for gas not taken from the Vermillion 370 Field, it paid the maximum lawful price (MLP) under Title I of the NGPA, 15 U.S.C. §§ 3311-3320 (1982).

4. When Transco received the volumes from the Vermillion 370 Field for which it made prepayments, it paid, in addition, an amount of money which rep-

---

[2] *See*, for example, Transco Tracking Rate Filing to be Effective November 1, 1984, Appendix C at 39 and 127.

resents the increase in the current minimum lawful price (MLP) over the MLP in effect at the time of Transco's prepayment.

Respectfully submitted,

/s/ Frederick Moring
Frederick Moring
Crowell & Moring
1100 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 452-5800

Attorneys for Associated Gas Distributors

/s/Robert G. Hardy
Robert G. Hardy
Andrews & Kurth
1730 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 662-2700

Attorney for Transcontinental Gas Pipe Line Corporation

Dated: July 3, 1985
Washington, D.C.

BEST AVAILABLE COPY

(22)

No. 84-1076

Supreme Court, U.S.
FILED
DEC 27 1985
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., *et al*
Appellees.

On Appeal from the Supreme Court of Mississippi

MOTION OF APPELLANT FOR LEAVE TO FILE RESPONSE TO SUPPLEMENTAL BRIEF OF COASTAL EXPLORATION, INC. AND RESPONSE BRIEF

JOHN M. GROWER
JEFFERSON D. STEWART
R. WILSON MONTJOY II
BRUNINI, GRANTHAM, GROWER & HEWES
1400 First National Bank Building
Post Office Drawer 119
Jackson, Mississippi 39205
(601) 948-3101

R. V. LOFTIN, JR.
THOMAS E. SKAINS
DAVID A. GLENN
Attorneys for Transcontinental Gas Pipe Line Corporation

December 27, 1985

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., *et al*
Appellees.

MOTION OF APPELLANT FOR LEAVE TO FILE RESPONSE TO SUPPLEMENTAL BRIEF OF COASTAL EXPLORATION, INC.

Transcontinental Gas Pipe Line Corporation (Transco) moves the Court for leave to respond to the presentation and characterization of a certain intervening matter by an Appellee, Coastal Exploration, Inc. (Coastal), and in support thereof would show as follows:

1. On December 9, 1985, Coastal filed its Motion to File Supplemental Brief After Argument. Said motion was granted on December 16, 1985. Coastal's motion and accompanying Supplemental Brief seek to bring to the Court's attention an Initial Decision of

an Administrative Law Judge regarding matters at issue in this cause. Coastal's motion and brief also argue that the Initial Decision supports its position in the instant case.

2. Transco desires to respond to Coastal's Supplemental Brief in order to demonstrate that the Initial Decision strengthens Transco's argument that Mississippi's Rule 48 conflicts with the exercise of federal jurisdiction and is therefore preempted. Transco's Reply to Coastal's Supplemental Brief is attached hereto.

WHEREFORE, PREMISES CONSIDERED, Transco moves the Court for leave to file its Response to Coastal's Supplemental Brief.

This the 27th day of December, 1985.

Respectfully submitted,

JOHN MARSHALL GROWER
(Counsel of Record)

JEFFERSON D. STEWART
R. WILSON MONTJOY II
BRUNINI, GRANTHAM, GROWER & HEWES

R. V. LOFTIN, JR.
THOMAS E. SKAINS
DAVID A. GLENN
Attorneys For Appellant
Transcontinental Gas Pipe
Line Corporation

TABLE OF AUTHORITIES

CASES:	Page
Maryland v. Louisiana, 451 U.S. 725 (1981)	4, 5
Northern Natural Gas Co. v. State Corporation Commission, 372 U.S. 84 (1963)	4, 5
STATUTES AND REGULATIONS:	
15 U.S.C. § 717r	2
18 C.F.R. §§ 385.711-13	2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

No. 84-1076

TRANSCONTINENTAL GAS PIPE LINE CORPORATION
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI AND COASTAL EXPLORATION, INC., *et al*
Appellees.

BRIEF OF APPELLANT IN RESPONSE TO SUPPLEMENTAL BRIEF OF COASTAL EXPLORATION, INC.

The Supplemental Brief of Coastal Exploration, Inc. (Coastal) brings to the attention of the Court the Initial Decision of an Administrative Law Judge which addresses whether or not Transcontinental Gas Pipe Line Corporation (Transco) can flow through to its customers certain costs resulting from Mississippi's Ratable Take Order, Statewide Rule 48. Transco would show that the Initial Decision demonstrates precisely the inevitable conflict between Mississippi's

Rule 48 and the jurisdiction of the FERC as previously discussed.[1]

1. The Initial Decision arose in the context of Transco's semi-annual purchased gas adjustment filing (PGA) with the FERC.[2] In its PGA, Transco sought to include in its resales rates the gas costs[3] resulting from, among other things, the enforcement of Mississippi's Rule 48. The Initial Decision was rendered after objection by the FERC staff and the Associated Gas Distributors to the prudence of Transco's purchases in Mississippi which were made in compliance with the State Oil & Gas Board Order and subsequent state court decisions.

Because Mississippi's action forced Transco to incur additional gas costs, Transco sought to pass through

---

[1]See Transco Br. at 30-34, Transco Reply Br. at 5-7, FERC Br. at 17-26, as well as the statements quoted from the presentation of Mr. Feit, FERC Solicitor, at oral argument. See Coastal's Supp. Br. at 2.

[2]Although the intervening matter brought to the attention of the Court by Coastal serves to confirm the jurisdictional conflict, it is an initial decision of an Administrative Law Judge, not a "FERC opinion" as characterized by Coastal. See Coastal's Supp. Br. at 3. The decision is subject to initial review and rehearing by the FERC and possible judicial review thereafter. 15 U.S.C. § 717r; 18 C.F.R. §§ 385.711-13. Thus the decision submitted by Coastal does not constitute action by the FERC and is not final. Indeed, Judge Megan, the administrative judge, expressly made his findings "subject to review by this Commission [the FERC]." Coastal's Supp. Br., App. at 10a.

[3]These costs include the additional gas costs arising from purchases of non-contract gas at "market price" made in order to comply with Rule 48 in lieu of of purchases under gas contracts which provide for prices below "market price." See Reply for Appellant at 4. See also Transco Br. at 30.

these costs in its PGA filing before the FERC. This places the FERC in a dilemma—adjust its regulations to accomodate State laws or penalize Transco for obeying Rule 48. In granting the requested pass through, the Administrative Law Judge, Judge Megan, stated that Transco "should not be placed in jeopardy for obeying an order of a duly constituted authority while that party undertakes successive appeals seeking to overturn an adverse decision." Coastal's Supp. Br., App. at 7a. Further, Judge Megan held that Transco, in his view, "is entitled, and is indeed required, to follow the decisions and orders of the Mississippi authorities until and unless they be overturned by the Supreme Court of the United States." *Id.* at 8a. Thus Mississippi has directly affected the cost of gas to consumers in other states, heretofore the exclusive province of the FERC.

2. FERC's dilemma is precisely that portrayed by Transco and the FERC in their briefs. See note 1, *supra.* As noted therein, the FERC clearly should have jurisdiction and authority to determine the prudence of Transco's costs. However, there is a clear conflict between Rule 48 and the FERC's exclusive jurisdiction over those gas costs. As the FERC stated in its brief:

> Thus, a practice that the Commission, under the statute, might have found to be an "abuse" meriting a denial of pass through if done at the pipeline's own initiative—the purchase of expensive deregulated gas when alternative lower cost supplies were available—is a required practice by order of the state.

FERC Br. at 21-22. See also Transcript of Oral Argument at 17-18, Coastal's Supp. Br. at 2. Judge

Megan has addressed this conflict by ruling that he had no choice but to accommodate Rule 48.

3. The Initial Decision places this case in virtually an identical position to *Maryland v. Louisiana*, 451 U.S. 725 (1981). *See* Transco Br. at 21, 30-31 and 33. Therein, Louisiana had imposed a tax on offshore gas which passed through the state. The Court found that the effect of the tax was to interfere with FERC's authority over transportation and sale of gas, specifically its authority over the allocation of costs. 451 U.S. at 746 and 749. The Court characterized Louisiana's action as a "substantial usurpation" of FERC authority. *Id.* at 749.

It is important to remember that it was not actual interference with an FERC ruling which was involved in *Maryland v. Louisiana.* Indeed, the FERC had passed the tax costs through to the consumer, pending judicial review of the law in question. *Id.* at 737 n. 13, 751 n. 25. Rather, the prohibited interference occurred between the downstream effect of the state enactment and the FERC's authority or jurisdiction over those downstream consequences:

> Under the Gas Act, determining pipeline and producer costs is the task of the FERC in the first instance, subject to judicial review. Hence, the further hearings contemplated by the Special Master to determine whether and how processing costs are to be allocated are as inappropriate as Louisiana's effort to preempt those decisions by a statute directing that processing costs be passed on to the ultimate consumer. *Even if the FERC ultimately determined that such expenses should be passed on in toto, this kind of decision-making is within the jurisdiction of the FERC; and the*

> *Louisiana statute, like the state Commission's order in Northern Natural Gas, supra, is inconsistent with the federal scheme and must give way. At the very least, there is an "imminent possibility of collision," ibid. The FERC need not adjust its ruling to accommodate the Louisiana statute. To the contrary, the state may not trespass on the authority of the federal agency.* As we see it, plaintiffs are entitled to judgment on the pleadings that § 1303(c) is invalid under the Supremacy Clause.

Id. at 751-52 (emphasis added).

The action of Judge Megan in adjusting his ruling to accommodate Mississippi's Rule 48 strongly supports Transco's position in this case. It clearly demonstrates the existence of the same type of conflict which prompted reversal in *Maryland v. Louisiana.* Just as in *Maryland v. Louisiana,* reversal of the offending state law is also required in this case.

This the 27th day of December, 1985.

Respectfully submitted,

JOHN MARSHALL GROWER
(Counsel of Record)

JEFFERSON D. STEWART
R. WILSON MONTJOY II
BRUNINI, GRANTHAM, GROWER & HEWES

R. V. LOFTIN, JR.
THOMAS E. SKAINS
DAVID A. GLENN
Attorneys For Appellant
Transcontinental Gas Pipe
Line Corporation